87-71

NO. _____

SUPREME COURT, U.S.
FILED
JUL 13 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court Of The United States

October Term, 1987

IN RE: OZARK RESTAURANT EQUIPMENT CO., INC.
JILL R. JACOWAY,
SUCCESSOR TRUSTEE ..... *Petitioner*

V.

BRUCE ANDERSON, ELMER DALE YANCEY, KENNETH EADS, ROBERT WHITELEY AND ANDERSON CAJUN'S WHARF ..... *Respondents*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

JILL R. JACOWAY
P. O. Drawer 3456
Fayetteville, AR 72702
(501)521-2621

QUESTION PRESENTED

Whether a cause of action based on an alter ego theory belongs to a Chapter 7 corporate debtor thereby conferring standing on the duly appointed Trustee to pursue the action on behalf of the debtor corporation's creditors.

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V.

BRUCE ANDERSON, ELMER DALE
YANCEY, KENNETH EADS,
ROBERT WHITELEY AND
ANDERSON CAJUN'S WHARF.....*Respondents*

PETITION FOR A
WRIT OF CERTIORARI TO
THE UNITED STATES
EIGHTH CIRCUIT
COURT OF APPEALS

PETITION
FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Jill R. Jacoway, the petitioner herein, prays that a writ of certiorari issue to review the judgment of The United States Eighth Circuit Court of Appeals entered in the above-entitled case on April 14, 1987.

OPINIONS BELOW

The opinion of The United States Eighth Circuit Court of Appeals is reported at 816 F.2d 1222 (8th Cir. 1987) and is printed in the Appendix hereto, infra, page A-1. The judgment of The United States Eighth Circuit Court of Appeals is printed in the Appendix hereto, infra, page C-1. The prior opinion of the United States District Court for the Western District of Arkansas, Fayetteville Division, also reprinted in the Appendix, infra, page A-27, is reported as follows: *In re Ozark Restaurant Equipment Co., Inc.* 61 B.R. 750 (W.D. Ark. 1986). The prior opinion of the United States Bankruptcy Court for the Western District of Arkansas, Fayetteville Division, also reported in the Appendix, infra, page A-47, is reported as follows: *In re Ozark Restaurant Equipment Co., Inc.*, 41 B.R. 476 (Bankr. W.D. Ark. 1984).

JURISDICTION

The judgment of the United States Eighth

Circuit Court of Appeals was entered on April 14, 1987. The jurisdiction of the Supreme Court is invoked under 28 U.S.C. §1254 (1).

QUESTIONS PRESENTED

Whether a cause of action based on an alter ego theory belongs to a Chapter 7 corporate debtor thereby conferring standing on the duly appointed Trustee to pursue the action on behalf of the debtor corporation's creditors.

STATUTES INVOLVED

Title 11 of the United States Code §§541, 544 and 704 are set out verbatim in the Appendix hereto, infra, page B-1.

STATEMENT OF THE CASE

The Chapter 7 Bankruptcy Trustee, of Ozark Restaurant Equipment Co., Inc. brought an action against the principals of that corporation alleging that the principals should be held personally liable for the debts of the corporation because of the abuses of the corporation by the principals. The Bankruptcy Court, having jurisdiction over this dispute pursuant

to 28 U.S.C. §1471 and 1481, and 11 U.S.C. §105, and General Order No. 24 of the United States District Court for the Eastern and Western Districts of Arkansas, consolidated this adversary proceeding with two others for trial.

On March 21, 1984, the Honorable Judge Baker signed an Order resolving all three adversary proceedings in favor of the Trustee. *In re Ozark Restaurant Equipment Co., Inc.*, 41 B.R. 476 (Bankr. W.D. Ark. 1984). The Bankruptcy Court found and the District Court agreed that the Trustee had convincingly proved that the defendants had abused the corporate structure of the Debtor, Ozark Restaurant Equipment Company, Inc. (hereinafter referred to as Ozark) and, therefore, the Bankruptcy Court "pierced the corporate veil" and held the subject parties personally liable.

The District Court's Order stated that the company was "grossly undercapitalized from the beginning," and that "the business never made a profit." *In re Ozark Restaurant Equipment Co., Inc.*, 61 B.R. 750, 751 (W.D. Ark. 1986). The company's markup on sales to Anderson-related enterprises was only seven percent while testimony established that the average restaurant equipment company's markup is at least thirty percent and typical markups for other Ozark customers was between twenty-eight and ninety percent. *Id.* at 751. While Mr. Anderson

disputed the Trustee's evidence, no witnesses were called to support his position nor was any documentary evidence submitted by Mr. Anderson. *Id.* at 752. The Bankruptcy Court and the District Court stated that they were most disturbed by admitted evidence that appellees, operating as Ozark had used fraudulent balance sheets to entice suppliers to sell merchandise to Ozark on credit. *Id.* at 752.

After the Bankruptcy Court completed a plenary hearing, it held for the Trustee. The defendants appealed to the District Court where the issue of the bankruptcy Trustee's standing to assert an *alter ego* claim on behalf of creditors was raised by the court *sua sponte.*

Thus, while agreeing that the factual issues of the case were clearly and convincingly against the appellee, the District Court reversed the Bankruptcy Court's judgment in the alter ego action. *Id.*

Ozark's Trustee subsequently appealed, arguing that a Chapter 7 Trustee does have standing to bring an alter ego claim on behalf of the debtor corporation's creditors. The Eighth Circuit Court of Appeals affirmed the District Court in an opinion handed down on April 14, 1987. In that opinion the Court concluded that the Bankruptcy Code does not give the Chapter 7 Trustee standing to bring an alter ego action. Trustee now petitions this Court to

review this standing issue in light of conflicting Federal Court of Appeals decisions.

The issue presented for review is that of whether a cause of action based on an alter ego theory belongs to a Chapter 7 corporate debtor thereby conferring standing on the duly appointed Trustee to pursue the action on behalf of the debtor corporation's creditors.

*Upon James G. Mixon's appointment as Bankruptcy Judge, he resigned as trustee of this case. The Bankruptcy Court thereupon appointed Jill R. Jacoway to serve as successor trustee by order dated February 29, 1984

REASONS FOR GRANTING WRIT

I.

THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS CREATES AN INTOLERABLE CONFLICT WITH OTHER APPELLATE COURT DECISIONS.

The essence of Trustee's alter ego action is that it seeks to recover money (i.e., property) from the defendants under the theory that the defendants are alter egos of the Debtor Corporation. Although usually asserted by creditors, an alter ego claim may be said to belong to a corporation. Once the corporate veil is properly pierced property in the hands of the debtor's alter ego becomes the property of the estate in bankruptcy. This axiom was recognized in dictum by the United States Supreme Court in *Samsel v. Imperial Paper and Color Corp.*, 313 U.S. 215 (1941).

Since the *Samsel* case, the bankruptcy courts have continued to recognize the fact that the property in the hands of an alter ego is property of the estate. In *In re F & C Services, Inc.*, 44 Bankr. 864 (Bankr. S.D. Fla. 1984), a trustee in bankruptcy had filed a complaint seeking turnover of property of a debtor, which had been transferred to an alter ego. In ordering turnover pursuant to §542, the court in *F*

& C Services noted that, "[i]t is well established that property of the debtor in possession, custody and control of its alter ego comprises property of the estate at the commencement of the case." *Id.* at 868.

Another bankruptcy court noted that an alter ego action is not "a chose in action on which the debtor-corporation could have sued outside of bankruptcy; (but a trustee) brings it simply to establish the identity of the alter egos with the corporation in order to determine what are *the assets of the estate.*" *In re Western World Funding, Inc.*, 52 Bankr. 743, 784 (Bankr. D. Nev. 1985).

The question remains, however, is an action under the alter ego theory an action belonging to the corporation? The Eighth Circuit Court of Appeals, citing, *inter alia,* 18 Am. Jur. 2d *Corporations* §46 (1985) and, in *accord, In re S.I. Acquisition, Inc.*, 58 B.R. 454, 460 (Bankr. W.D. Texas 1986) answers in the negative.

However, the Fifth Circuit Court of Appeals reversed the *S.I. Acquisition* holding, relied upon by the Eighth Circuit. The Fifth Circuit concluded that an alter ego action is a right of action belonging to a corporation and, as such, is property of the estate within the meaning of §541(a)(1) of the Bankruptcy Code. *In re S.I. Acquisition, Inc.*, 817 F.2d 1142, 1153 (5th Cir. 1987).

In so holding, the Fifth Circuit tracked the elements required in Texas to pierce the corporate veil:

> [An alter ego allegation] is shown from the total dealings of the corporation and the individual, including the degree to which corporate formalities have been followed and corporate and individual property have been kept separate, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes. . . . Alter ego's rationale is: "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors."

S.I. Acquisition at 1152 citing *Castleberry v. Branscum,* 721 S.W.2d 270, 272 (Tex. 1986). Thus Texas' alter ego law requires that the corporation and the control person be considered a single entity.

While conditions under which a corporate entity in Arkansas may be disregarded vary according to the circumstances of each case, generally it must be proved that the privilege of transacting business in the corporate form has been abused to the detriment or injury of a third person. *Eagle Star Ins. Co., Ltd. v. Deal,* 474 F.2d 1216 (8th Cir. 1973). This requirement of injury to a third person makes,

according to the Eighth Circuit, an alter ego action personal to corporate creditors rather than the corporation itself. *Ozark,* 816 F.2d 1225. The Court fails to elucidate why such an action might not belong to a corporation.

Admittedly there is a dearth of case law in support of the view that the corporation has a right to bring an alter ego action. However, this is only logical for:

> The defendants who so completely dominate the corporation as to constitute its alter ego are not likely to institute an action to determine their own liability for corporate debts. Therefore, it is not surprising that the parties can produce no such case.

In re Western World Funding, Inc., 52 B.R. 743, 784 (Bankr. D. Nev. 1985). In truth, this scarcity of cases argues well for assuring the right of a trustee to assert, as an independent voice, such an action to protect corporate creditors.

Because the Debtor-corporation has an equitable interest of its own in assuring that it can meet its responsibility to its creditors, it has the right to bring an alter ego action for the equitable remedy of piercing the corporate veil.

Therefore, while the alter ego claim, like the corporate trust fund or shareholder derivative suit, is usually brought by creditors, it may be said to belong

to the corporation, itself. It necessarily follows that the equitable interest inures to the Trustee pursuant to Code §541(a)(1). The Court should accordingly grant certiorari in this case, resolve this conflict between the circuits and determine that an alter ego action may be considered as a corporate right which inures to the trustee in bankruptcy situations.

II.

THE RAMIFICATIONS OF THE LOWER COURT'S DECISION HEREIN WILL ADVERSELY AFFECT FEDERAL BANKRUPTCY LAW.

Notwithstanding the foregoing, the District Court and Eighth Circuit Court of Appeals in the instant case opined that the Code failed to convey standing on a trustee to assert an alter ego action on behalf of creditors. These holdings were based in a large part on the Court's holding in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1971). There, in an opinion authored by Justice Marshall, the Court held that a reorganization Trustee does not have standing to sue an indenture trustee on behalf of debenture holders.

In *Caplin*, the Court was concerned with the trustee's attempt to increase the assets of the debtor for the benefit of a *specific* class of creditors, the

debenture holders. *Caplin* at 421 F.N. 12. It is significant that *Caplin* involved a Chapter X reorganization and, "(I)n enacting Chapter X, Congress had protection of public investors primarily in mind." *Caplin* at 422. Not only was Chapter X involved, *Caplin* also involved the Trust Indenture Act of 1939 as well as intervention from the Securities Exchange Commission. (Interestingly, the SEC argued for reversal in *Caplin*, i.e., for granting the trustee the right to sue third parties on behalf of debenture holders.)

Most significantly, however, the *Caplin* trustee was bringing a cause of action on behalf of a "special class" of creditors (debenture holders), not on behalf of all creditors of the debtor corporation. The Court was correct to be concerned that this special class, already protected both under other federal laws and by other federal agencies, should receive favored treatment by the trustee to the possible detriment of other creditors.

The Federal District Court below and the Eighth Circuit interpret *Caplin* to mean that a trustee has no standing to sue on behalf of all creditors of the estate. Actually, *Caplin* holds that trustees may not sue on behalf of a "special class" of creditors who are some, but not all, of the creditors of the estate. The trustee in the instant case was suing to insure equality and to protect the interests of *all* creditors.

The *Caplin* decision was concerned with the speculative nature of suing third parties on behalf of debenture holders as well as the very real possibility of subrogation whereby the third party sued would simply be sustituted for debenture holders as a claimant. These concerns are not applicable in this case. By permitting the trustee to pursue an alter ego action the Court assures *all* creditors of a pro rata share of the recovery. There is no speculation in the instant case as the lower courts are in agreement as to respondents' abuse of the debtor's corporate structure. Concern regarding speculative law suits, while understandable, should not daunt a conscientious trustee in her pursuit to recover debtor's assets as charged by law. And, while *Caplin* concerned an indenture trustee, making the possibility of subrogation a very real issue, here such a possibility is remote if it exists at all.

The District Court here furthermore suggests that individual creditors are in a better position to pursue alter ego actions. This suggestion is inconsistent with modern bankruptcy concepts. It has been said that "the theme of the Bankruptcy Act (was) equality of distribution." *Samsel, supra,* U.S. 219, S.Ct. 907. Today, it is recognized that "[t]he *guiding premise* of the Bankruptcy Code, like its predecessor, the Bankruptcy Act, is the *equality of distribution* of assets among creditors." *Cunard SS.*

Co. v. Salem Reefer Services A.B., 773 F.2d 452, 459 (2nd Cir. 1985). (Emphasis added.)

The primary bankruptcy purpose of equality of distribution can only be fulfilled where individual creditors are prohibited from bringing actions on their own behalf, where the action belongs to all creditors equally. Because the abusive behavior of the principals of the debtor corporation harmed all creditors of the corporations, an action to pierce the corporate veil under the alter ego theory belongs to all creditors equally, and it should only be brought on behalf of all creditors.

The power of the trustee to bring an alter ego action as a representative of all creditors is discussed at length in the case of *In re Western World Funding, Inc.*, 52 Bankr. 743 (Bankr. D. Nev. 1985). In bringing an action under the alter ego theory,

> . . . the trustee does not seek to represent *particular* creditors who may have [personal claims] . . .; the alter ego action is unlike those personal creditor claims . . .; [and] the [alter ego] doctrine need not rest upon any consideration of the *particular* creditor's dealings with the defendants. *Ibid.*, 781-782. (Emphasis added.)

In fact, it is the trustee's duty to act on behalf of all creditors. (The court, in *Western World,* cited as authority for the standing of the trustee to bring the alter ego action in the bankruptcy court 11 U.S.C.

§§544, 541 and 704. *Id.* at 783.) Moreover, the essence of an alter ego claim is that it seeks to tap a *pool* from which to satisfy its claims against the Debtor. This "pool" is made up of the assets of the alleged alter ego. Under the District Court's theory of recovery, this "pool" is equally available to all other creditors of the Debtor. We think that it is safe to assume that this "pool" is infinite.

If one creditor were allowed, by its diligence, to tap this pool outside of the bankruptcy court, it would be able to obtain satisfaction of its claims against the Debtor from the alter ego. The first among other creditors to follow would drain the remainder of the pool, and the remaining creditors would be denied their right to an equitable share of these available assets presenting the quintessential example of first-come-first-served.

As the Fifth Circuit Court noted in *MortgageAmerica,* "the day of unfair and unseemly races to the courthouse is long gone . . . [it is] beyond cavil that the principle of first-come-first-served has no place in bankruptcy law . . ." *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1278 (5th Cir. 1983).

Other interests protected by granting trustee standing to assert alter ego claims on behalf of creditors include those of comity and judicial economy. To permit the trustee to represent creditors

will insure that the debtor's affairs will be centralized in a single forum thereby preventing conflicting judgments in different courts. These interests will be disserved if this court were to deny trustee's standing.

Finally, in *Ozark*, the Eighth Circuit went to great length to track the legislative history of the revised Bankruptcy Code and, in particular §544. That court discussed the omission in the final legislation of proposed language which addressed the *Caplin* issue. Again, it is important to note that *Caplin* was a very narrow case concerning the trustee's standing to bring an action on behalf of a special class of creditors already protected under existing law. For Congress to have granted a trustee the power to bring an action on behalf of a "special class" of creditors would have, indeed put the trustee in an untenable position. A trustee should not have those powers. The "special class" should be represented by their own advocate and the trustee should represent "all creditors." For Congress to attempt to develop specific powers for the Trustee to avail herself in every factual situation would be a Herculean task. Such a task was not only unnecessary but would in fact impede the trustee in accomplishing her primary and fundamental responsibility, the protection of all creditors' interests. In pursuit of that responsibility the Trustee has been granted both broad and general powers unfettered by

specific and accordingly restrictive regulations. Deleting the modifiers, §544 as enacted grants to the trustee all rights and powers of a creditor. Since a creditor could have brought an alter ego action, so can the trustee. This, petitioner submits, explains the congressional silence after *Caplin*.

CONCLUSION

Thus, for the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

/s/Jill R. Jacoway

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July 13, 1987

CERTIFICATE OF SERVICE

I, Jill R. Jacoway, hereby certify that I have served a true and correct copy of the above and foregoing document on all parties listed below by placing same, postage prepaid, in the U.S. Mail this 13th day of July, 1987.

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JILL R. JACOWAY

Appendix

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APPENDIX A

OPINIONS BELOW

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APPENDIX B

STATUTES INVOLVED

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APPENDIX C

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Judgment of the United States Bankruptcy Court, Western District of Arkansas, Fayetteville Division, No. AP 82-883, entered June 27, 1985 ..... C-5

Judgment of the United States Bankruptcy Court, Western District of Arkansas, Fayetteville Division, No. AP 82-884, entered June 27, 1985 ..... C-6

APPENDIX A

UNITED STATES
COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 86-1729

In Re: Ozark Restaurant
Equipment Co., Inc.,
James G. Mixon, Trustee

Appellant

v.
Bruce Anderson, Elmer Dale
Yancey, Kenneth Eads, Robert
Whiteley and Anderson Cajun's
Wharf

Appellees

James G. Mixon, Trustee

Appellant

v.
Anderson Cajun's Wharf

Appellee

James G. Mixon, Trustee
v.
Ed Yancey, Bruce Anderson
and Kenneth Eads

Appellees

Filed April 14, 1987

Before McMILLAN, JOHN R. GIBSON, AND MAGILL, Circuit Judges.

MAGILL, Circuit Judge.

The sole issue in this appeal is whether a Chapter 7 bankruptcy trustee has standing to assert, on behalf of the debtor corporation's creditors, an alter ego action against the principals of the corporation. The district court (NOTE 1) held in the negative. For the reasons discussed below, we affirm.

I. BACKGROUND.

In September of 1980, Bruce Anderson and Elmer Dale Yancey purchased Ozark Restaurant Equipment Co., Inc. ("Ozark") of Springdale, Arkansas, the debtor in this case. Both were 50% shareholders and directors of the corporation; Yancey was also an officer. In addition to owning Ozark stock, Anderson owned 50% or more of the stock in a number of other companies with which Ozark did

1 The Honorable H. Franklin Waters, Chief Judge, United States District Court for the Western District of Arkansas. The district court's opinion is reported as *In re Ozark Restaurant Equipment Co.*, 61 B.R. 750 (W.D. Ark. 1986).

business. (NOTE 2) On August 24, 1982, after an abysmal performance, Ozark filed for relief under Chapter 7 of the Bankruptcy Code.

In October of 1982, the Chapter 7 trustee of Ozark filed three adversary proceedings which were subsequently consolidated for trial before the bankruptcy court. The first proceeding was an alter ego action, which was brought solely by the trustee on behalf of all of Ozark's creditors (NOTE 3) against the following defendant-principals of Ozark: Anderson; Yancey; Kenneth Eads, director and president of Ozark; Robert Whiteley, a business consultant hired by Anderson to help with Ozark's finances; and Anderson Cajun's Wharf, Inc. The trustee alleged, *inter alia,* that because of the defendant-principals' abuse of the corporation, the corporate veil should be pierced and the individuals should be held personally liable for Ozark's debts. The second proceeding was an action by the trustee to recover an unpaid debt from Port City Equipment Company. In the third proceeding, the trustee sought recovery of certain of

[2] These companies included three restaurants which were operated by Anderson Cajun's Wharf, Inc., of which Anderson was the chief executive officer; Gonzales & Gertrude's, another restaurant of which Anderson was the CEO; Port City Equipment Company; and Port City Seafood Company.

[3] At oral argument, the trustee, in response to a question from this court, stated that the creditors were asked to join in the action, but that none of them wished to do so.

Ozark's loan payments to McIlroy Bank & Trust as preferential transfers. On March 21, 1984, the bankruptcy court ordered judgment in favor of the trustee on all three claims. *In re Ozark Restaurant Equipment Co.*, 41 B.R. 476 (Bankr. W.D. Ark. 1984). (NOTE 4) All defendants except Eads appealed

4 First, the bankruptcy court held that Port City Equipment Company was liable to Ozark under 11 U.S.C. §542 for the unpaid debt. *In re Ozark*, 41 B.R. at 479. Second, the court allowed the trustee to recover Ozark's loan payments to McIlroy Bank & Trust as preferential transfers. *Id.* at 479-80. In relation to this claim, the court also held that Anderson and Yancey, as guarantors of the loan, were liable to the bank for the amount recovered by the trustee and also for the balance due on the note. *Id.* at 480. Finally, as to the alter ego claim, the court found that Ozark was a mere instrumentality of the principals, and thus "pierced the corporate veil," holding the four individuals jointly and severally liable for $136,653.38 or the amount of unsecured debt listed in the bankruptcy petition. *Id.* at 480-81. The court pierced the veil based on its numerous findings of corporate abuse, including grossly inadequate capitalization; heightened fiduciary obligations of Yancey and Anderson as sole shareholders; Ozark's never having made a profit, and its net worth plummeting from $(1,400) in 1980 to $(146,000) in 1982; Anderson-related companies profiting from Ozark because of, among other things, low sale mark-ups and no interest on accounts payable; failure to keep adequate books and records, distribution of false financial statements; failure to pay taxes; and, the failure to hold regular meetings of the shareholders and directors. *Id.*

the judgment. (NOTE 5)

On May 22, 1986, the district court issued an order affirming the bankruptcy court's judgment with respect to the unpaid debt claim, but reversing the court's judgment in the alter ego action. *In re Ozark Restaurant Equipment Co.*, 61 B.R. 750 (W.D. Ark. 1986) (NOTE 6) Regarding the alter ego claim, the court, relying heavily on *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), determined that a Chapter 7 trustee has no standing on his own to bring an alter ego action on behalf of the debtor corporation's creditors. *Id.* at 757. The

5 The defendants initially appealed the bankruptcy court's judgment in April of 1984. The district court, however, dismissed the appeal as untimely. On appeal, this court vacated the district court's dismissal of the appeal, and instructed the district court to remand the case to the bankruptcy court for entry of the three judgments in accordance with bankruptcy rules without prejudice to the taking of a timely appeal to the district court. *In re Ozark Restaurant Equipment Co.*, 761 F.2d 481, 484 (8th Cir. 1985). Following entry of the judgments by the bankruptcy clerk, the defendants filed, on July 8, 1985, a timely notice of appeal to the district court.

6 Although the district court did not rule on the bankruptcy court's judgment in the preference action, it appears to this court, after a careful review of the record in light of the applicable law, that the bankruptcy court's judgment in that action should also have been affirmed. In any event, neither this claim nor the unpaid debt claim has been appealed to this court.

court, however, remanded the case for consideration of whether the business actions which caused the bankruptcy court to pierce the corporate veil constituted transfers within the meaning of the Code and were therefore possibly recoverable by the trustee under 11 U.S.C. §§547 or 548 (preferences or fraudulent transfers). *Id.* Ozark's trustee subsequently appealed, arguing that a Chapter 7 trustee does have standing to bring an alter ego claim on behalf of the debtor corporation's creditors.

II. DISCUSSION.

Although acknowledging that the district court had the right to raise the standing question, the trustee argues that the court's holding was incorrect as a matter of law. The trustee maintains that a Chapter 7 trustee has standing to assert an alter ego claim on behalf of the unsecured creditors of the debtor corporation based on three different areas of the Bankruptcy Code: (1) 11 U.S.C. §544; (2) 11 U.S.C. §§704 and 541; and (3) 11 U.S.C. §105 and general equitable principles running throughout the Code. We begin by addressing the trustee's second argument.

A. 11 U.S.C. §§704 and 541.

Section 704 of the Code outlines the duties of a Chapter 7 trustee and requires the trustee to "collect and reduce to money the *property of the estate* for

which the trustee serves * * *." 11 U.S.C. §704(1) (emphasis added). Section 541 defines "property of the estate" and for our purposes, the relevant subsection is 541(a)(1), which defines property of the estate as "all legal or equitable interests of the debtor in property as of the commencement of the case." *Id.* §541(a)(1). In arguing that Section 704 permits a Chapter 7 trustee to pursue an alter ego theory cause of action to pierce the corporate veil on behalf of the *creditors* of the debtor corporation, the trustee failed to acknowledge the key limiting language in Section 541(a)(1)—property of the estate comprises only "legal and equitable interests *of the debtor.*" *Id.* (emphasis added). Upon further examination of Sections 704 and 541 and the nature of the alter ego action, it becomes apparent that the trustee's standing argument based on these two sections must fail.

First, it is clear that causes of action belonging to the *debtor* at the commencement of the case are included within the definition of property of the estate. *E.g.*, 4 Collier on Bankruptcy §541.10[1], at 541-62 (15th ed. 1986). Any of these actions that are unresolved at the time of filing then pass to the trustee as representative of the estate, who has the responsibility under Section 704(1) of asserting them whenever necessary for collection or preservation of the estate. *Id.* §704.02, at 704-6 to -7. For example, these sections give the trustee authority to bring an action for damages on behalf of a debtor corporation

against corporate principals for alleged misconduct, mismanagement, or breach of fiduciary duty, because these claims could have been asserted by the debtor corporation, or by its stockholders in a derivative action. *See, e.g., Pepper v. Litton,* 308 U.S. 295, 307 (1939) (interpreting section 70a(6) of the old Bankruptcy Act, a predecessor of Sections 541(a)(1) and 704(1) of the Code); *Koch Refining v. Farmers Union Central Exchange, Inc.,* 56 B.R. 242, 243 (N.D. Ill. 1985); 4 Collier on Bankruptcy, *supra,* §541.10[8], at 541-69; *see also Henderson v. Rounds & Porter Lumber Co.,* 99 F. Supp. 376, 380 (W.D. Ark. 1951) (quoting with approval 4A Collier on Bankruptcy §70.29, at 429-33. (14th ed. 1978). Accordingly, whenever a cause of action "belongs" to the debtor corporation, the trustee has the authority to pursue it in bankruptcy proceedings.

Where, however, "the applicable state law makes such obligations or liabilities run to the corporate creditors personally, rather than to the corporation, such rights of action are not assets of the estate under Section 541(a) that are enforceable by the trustee [under Section 704(1)). 4 Collier on Bankruptcy, *supra,* §541.10[8] at 541-69 to 541-70.; *accord Henderson,* 99 F. Supp. at 380 (quoting the 1978 edition of Collier on Bankruptcy); *In re Green Valley Seeds, Inc.,* 27 B.R. 34, 36 (Bankr. D. Ore. 1982); *see In re S I Acquisition, Inc.,* 58 B.R. 454, 461, 462 (Bankr. W.D. Tex. 1986). In this respect, we recognize that "[g]enerally, the corporate veil is

never pierced for the benefit of the corporation or its stockholders[.]" 18 Am. Jur. 2d *Corporations* §46 (1985); *accord In re S I Acquisition,* 58 B.R. at 460; *but see* 1 Fletcher Cyclopedia on the Law of Private Corporations §41, at 388 (1983) (hereinafter "Fletcher Cyclopedia"). This general statement of the law is followed in Arkansas, where the courts have held that "[a] corporate entity is to be disregarded only if the corporate structure is illegally or fraudulently abused *to the detriment of a third person.*" *Thomas v. Southside Contractors, Inc.,* 260 Ark. 694, 543 S.W.2d 917, 919 (1976) (emphasis added) (citing *Rounds & Porter Lumber Co. v. Burns,* 216 Ark. 288, 225 S.W.2d 1 (1949)). Thus, the obligations and liabilities of an action to pierce the corporate veil in Arkansas do not run to the corporation, but to third parties, *e.g.*, creditors of the corporation.

Further, although an action to pierce the corporate veil may be brought under a number of different theories, the "alter ego" doctrine of piercing the corporate veil

> fastens liability on the individual who uses a corporation merely as an instrumentality to conduct his own personal business, *and such liability arises from fraud or injustice perpetrated not on the corporation but on third persons dealing with the corporation.* [Footnote omitted.] The corporate form may be disregarded only where equity requires the action to assist a third party. [Footnote omitted.] Accordingly, a sole shareholder may not choose to

ignore the corporate entity when it suits his convenience. [Footnote omitted.]

1 Fletcher Cyclopedia, *supra*, §41.10, at 397 (emphasis added).

Because the corporate entity will be disregarded under Arkansas law only if it has been abused to the detriment of a third person, and because the nature of the alter ego theory of piercing the corporate veil makes it one personal to the corporate creditors rather than the corporation itself, it is axiomatic that the claim does not become property of the estate under Section 541(a)(1), nor is it enforceable by the trustee under Section 704(1). Accordingly, we conclude that the trustee here does not have standing under these sections to bring an alter ego action on behalf of Ozark's creditors. (NOTE 7)

7It is possible that some states permit the corporation or its stockholders to assert an alter ego cause of action to pierce the corporate veil, and thus, that a bankruptcy trustee would be able to enforce the claim on behalf of the debtor corporation under Sections 541 and 704. *See In re Western World Financing, Inc.*, 52 B.R.743, 783 (Bankr. D. Nev. 1985) (although not sole basis of decision, court held that under Nevada alter ego doctrine, the corporation has an equitable interest in assets of the alter ego and thus, the action is one that is property of the estate under Section 541(a)(1); *see also In re Energy Cooperative, Inc.*, 58 B.R. 132, 134-35 (N.D. Ill. 1985) (apparently interpreting alter ego action to pierce the corporate veil as a suit against the

B. 11 U.S.C. §544.

The trustee's principal argument in this case is based on Section 544 of the Code, 11 U.S.C. §544. (NOTE 8) The trustee maintains that Section 544(a),

principals for mismanagement, misappropriation of assets, or breach of fiduciary duty). Arkansas, however, is not one of those states, as evidenced by cases such as *Thomas*, 543 S.W.2d 917, and *Burns*, 225 S.W.2d 1.

[8]Section 544 of the Code provides:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or

"strong-arm clause," enables the trustee to pursue an alter ego action in his creditor's capacity, because that section gives the trustee the rights and powers of a creditor who could have obtained a judicial lien, whether or not such a creditor exists. *See* 11 U.S.C. §544(a)(1). Additionally, the trustee maintains that Section 544(b), which allows a trustee to avoid certain transfers of the debtor that are voidable under applicable law by a creditor holding an unsecured claim, *see id.* §544(b), also gives the trustee standing to pursue an alter ego action for the benefit of all creditors.

Admittedly, a trustee's rights and powers under Section 544 are extensive. We do not believe, however, that they encompass the ability to litigate claims, such as the instant alter ego cause of action, on behalf of the debtor corporation's creditors. A careful reading of *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), supports this conclusion, as recognized by the district court.

not such a purchaser and [sic] has perfected such transfer exists.

(b) the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable under section 502(e) of this title.

In *Caplin,* the Supreme Court held that a reorganization trustee lacked standing under the old Bankruptcy Act to assert, on behalf of the bankrupt corporation's creditors (debenture holders), claims of misconduct against a third party (the indenture trustee). *Id.* at 434. Having recognized that the Bankruptcy Act itself contained no provisions authorizing the trustee to so act, the Court proceeded to analyze the issue in terms of "the nature of [reorganization] proceedings, the role of the trustee in reorganization, and the way in which standing to sue on behalf of debenture holders would affect or change that role." *Id.* at 422. After discussing these criteria, *id.* at 422-27, the Court determined that three reasons militated against allowing the trustee to have standing.

First, the Court found that nowhere in the statutory reorganization scheme was there any suggestion that the trustee should "assume the responsibility of suing third parties on behalf of debenture holders." *Id.* at 428. The Court noted that under 11 U.S.C. §567(3) of the Bankruptcy Act, the trustee had a duty to investigate potential causes of action of the estate, but that nothing in that section enabled the trustee to collect money not owed to the estate. *Id.* Further, the Court noted that 11 U.S.C. §110 of the Act (the relevant parts of which are now embodied in Sections 541 and 544 of the Code, 11 U.S.C. §§541, 544) did not give the trustee this

authority, *id.*, but rather, "[the trustee's] task is simply to collect and reduce to money the property of the estates for which [he serves]." *Id.* at 428-29 (quoting 11 U.S.C. §75(a)(1) of the Act, now Section 704(1) of the Code, 11 U.S.C. §704(1)). Second, the Court noted that the bankrupt corporation had no claim against the indenture trustee, and that at the most, the trustee's claims of misconduct involved a situation where the corporation and the indenture trustee were *in pari delicto*. *Id.* at 430. The Court thus expressed concern over whether the indenture trustee would be subrogated to the claims of the creditors. *Id.* Third, the Court was concerned that "a suit by [the trustee] on behalf of debenture holders may be inconsistent with any independent actions that they might bring themselves." *Id.* at 431-32. The Court noted that the trustee's action would not preempt suits by the individual creditors, and that such suits would be likely because it would be "extremely doubtful that the trustee and all debenture holders would agree on the amount of damages to seek, or even on the theory on which to sue." *Id.* at 432. Relatedly, the Court expressed concern over who would be bound by the settlement obtained by the trustee. *Id.*

Although the Court concluded that the above reasons required a finding against the trustee, the Court expressly invited Congress to decide differently:

> Congress might well decide that reorganizations have not fared badly in the 34 years since [the reorganization chapter] was enacted and that the *status quo* is preferable to inviting new problems by making changes in the system. Or, Congress could determine that the trustee in a reorganization was so well situated for bringing suits against indenture trustees that he should be permitted to do so. In this event, Congress might also determine that the trustee's action was exclusive, or that it should be brought as a class action on behalf of debenture holders, or perhaps even that the debenture holders should have the option of suing on their own or having the trustee sue on their behalf. Any number of alternatives are available. Congress would also be able to answer questions regarding subrogation or timing of law suits before these questions arise in the context of litigation. Whatever the decision, it is one that only Congress can make.

Id. at 434-35. Congress, however, declined to accept the invitation.

In 1978, six years after *Caplin* was decided, Congress overhauled the bankruptcy laws when it enacted the Bankruptcy Code. As part of the revision, Congress consolidated former sections 70c and 70e of the Act (11 U.S.C. §§110(c), (e) of former title 11) into Sections 544(a) and (b) of the Code, respectively, which apply to both reorganization and liquidation trustees. Although Section 544 clarified and expanded the trustee's role with respect to creditors, in no way was it changed to authorize the trustee to bring suits on behalf of the estate's

creditors against third parties. In fact, the legislative history suggests just the opposite.

As originally proposed by the House, Section 544 was to contain a subsection (c), which was intended to overrule *Caplin*. (NOTE 9) It is extremely

9 Subsection (c) would have provided as follows:

(c)(1) The trustee may enforce any cause of action that a creditor, a class of creditors, an equity security holder, or a class of equity security holders has against any person, if—

(A) the trustee could not recover against such person on such cause of action other than under this subsection;

(B) recovery by the trustee for the benefit of such creditor or equity security holder or the members of such class will reduce the claim or interest of such creditor or equity security holder or of such members, as the case may be, against or in the estate;

(C) there is a reasonable likelihood that recovery against such person will not create an allowable claim in favor of such person against the estate; and

(D) enforcement of such cause of action is in the best interest of the estate.

(2) If the trustee brings an action on such cause of action—

(A) the court, after notice and a hearing, may stay the commencement or continuation of any other action on such cause of action; and

(B) the clerk shall give notice to all creditors or equity security holders that could have brought an action on such cause of action if the trustee had not done so.

(3) A judgment in any such action brought by the trustee binds all creditors or equity security holders that could have brought an action on such

noteworthy, however, that this provision was deleted before promulgation of the final version of Section

> cause of action. Any recovery by the trustee, less any expense incurred by the trustee in effecting such recovery, shall be for the benefit only of such creditors or equity security holders.
> H.R. 8200, 95th Cong., 1st Sess. 416-17 (1977).

A legislative commission initially recommended that the *Caplin* problem could be "partially solved by conditioning the right of the trustee to enforce a claim on such actions being 'in the best interest of the estate.'" Report of the Committee on the Bankruptcy Laws of the United States, H.R. Doc. 93-137, 93d Cong., 1st Sess. Part I at 201 (1973) (footnoting a proposed section of the bill). The House apparently agreed that *Caplin* should be overruled and included subsection (c) in its original proposed version of Section 544. In explaining the import of subsection (c), the House Report stated:

> Subsection (c) is new. It overrules *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), which precluded a [reorganization] trustee from enforcing a claim on behalf of debenture holders against an indenture trustee. The trustee is permitted to act as a class representative under this provision if the trustee has no other basis on which to recover on the claim involved; recovery will reduce the claim of a class of creditors or equity security holders and will not give rise to a corresponding but offsetting right of subrogation; and enforcement of the cause of action is in the best interest of the estate. Recovery in such an action is for the benefit of the class of creditors or equity security holders on whose rights the trustee has based the action. A judgment in the action binds all creditors or equity security holders that could have brought the action, and the court may stay the commencement or continuation of any other action on the same cause of action. All

544. (NOTE 10) Because subsection (c), as a part of Section 544, would have applied to both reorganization and liquidation trustees, and because Congress refused to enact subsection (c), we believe Congress' message is clear—*no* trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee as in the present case, has power under Section 544 of the Code to assert general causes of action, such as the alter ego claim, on behalf of the bankrupt estate's creditors. Further, although we believe congressional intent is clear and is thus determinative of the issue, because *Caplin* is still good law and is the only Supreme Court case to address the standing question, albeit in a reorganization setting, we feel obliged to address how the Court's concerns in that case apply to the case at bar.

creditors that could have brought the action are given notice of the trustee's suit, and nothing precludes such creditors from retaining their own attorneys and joining the action in their own behalf. H.R. Rep. 95-595, 95th Cong., 1st Sess. 370-71 (1977).

10 After the Senate adopted an amendment in the nature of a substitute to the bill originally proposed by the House, the two houses met and agreed upon a compromise bill. In a joint explanatory statement regarding the compromised provisions, the only reference to the proposed subsection (c) was a follows: "The House amendment deletes section 544(c) of the House bill." 124 Cong. Rec. H11,097 (Sept. 28, 1978).

First, just as there was nothing in the statutory reorganization scheme of the old Bankruptcy Act authorizing the trustee to collect money not owed to the estate, *see Caplin*, 406 U.S. at 428-29, similarly, there is nothing in Section 544 or the liquidation framework of the Code authorizing a chapter 7 trustee to collect money not owed to the estate. Rather, the Chapter 7 trustee's sole relevant duty regarding collection of money is under Section 704(1), and is geared to Section 541(a)(1), requiring the trustee to collect and reduce to money, among other things, the legal and equitable interests *of the debtor*. *See* 11 U.S.C. §§704(1), 541(a)(1). As already discussed, *see* Part A, *supra*, and as recognized by the district court, the alter ego action fails to meet this ontological test. *In re Ozark*, 61 B.R. at 754-57; *accord In re S I Acquisition, Inc.*, 58 B.R. 454, 461 (Bankr. W.D. Tex. 1986); *see Stodd v. Goldberger*, 73 Cal. App. 3d 827, 141 Cal. Rptr. 67, 72-73 (1977) (same result under Bankruptcy Act).

Moreover, contrary to the trustee's suggestion, we do not believe that Section 544 in its present form grants the trustee this right. First, as discussed above, in declining to explicitly authorize such standing in the wake of *Caplin*, it is difficult to ascertain how congressional intent could be stronger. Second, to argue that Section 544 in its present form grants the trustee this power is, we believe, to misconstrue the section's intended application.

Although Sections 544(a) and (b) are admittedly broader than their predecessors, the substantive changes do not in any way suggest that the trustee was given the additional power to bring general causes of action on behalf of the estate's creditors. (NOTE 11) In this vein, we note that Sections 544(a)

11 As summarized by one author:

> The concept of §70c of the Act is largely followed in §544(a) of the Code with, however, some drafting improvements and at least one substantive change. Section 544(a) gives the trustee the status of a creditor that extends credit to the debtor at the time of commencement of the case and obtains a judicial lien at such time or has an execution returned unsatisfied. [Footnote citing Sections 544(a)(1) and (2) omitted.] With respect to real property the trustee is also given the rights of a bona fide purchaser. [Footnote citing Section 544(a)(3) omitted.] In each instance the rights afforded the trustee exist without regard to any knowledge of the trustee or of any creditor.

P. Murphy, Creditors' Rights in Bankruptcy §12.04, at 12-5 (1980).

Further:

> The successor to §70e of the Act is §544(b) of the Code [footnote quoting Section 544(b) omitted] which contains few, if any, substantive changes from §70e. The requirement that the actual creditor have a provable claim has been deleted with the deletion of the whole concept of provability found in §63 of the Act from the Code. However, the claim must be one that is allowable under §502 or not allowable only under §502(e). The latter section deals with claims of sureties what are disallowed only until the principal creditor has been paid in full. [Footnote omitted.]
>
> Any possible argument that the trustee might

and (b) are flavored with the notion of the trustee having the power to avoid "transfers" of the debtor, as were its predecessors, sections 70c and e of the Act. Further, it does not appear that Section 544 should be interpreted in a vacuum separate and apart from other relevant sections of the Code. As discussed by a noted author, Section 544 gives the trustee the power to avoid transfers of, or liens and encumbrances on, the debtor's property that he would be unable to challenge under other sections of the Code, such as 11 U.S.C. §§547 (preferences), 548 (fraudulent transfers or obligations), or 549 (post-petition transfers). 4 Collier on Bankruptcy §544.01, at 544-2 (15th ed. 1986). An alter ego action, however, does not entail invalidating of a transfer of interest, but instead imputes the obligations of one party to another regardless of "transfers."

In summary, no where in Sections 544(a) or (b), NOTE [12] nor in other relevant provisions of the Code is

assert the rights of an actual secured creditor has been ended by the wording of §544(b) which provides that the claim must be an unsecured one. *Id.* §13.05, at 13-5.

[12]In arguing that Section 544(a)(1), which gives the trustee the status of a hypothetical lien creditor, authorizes the trustee to bring an alter ego cause of action, the trustee relies heavily on *In re Western World Funding, Inc.*, 52 B.R. 743 (Bankr. D. Nev. 1985). In *Western World*, the court did hold that the trustee had standing under Nevada law to bring an

there any suggestion that the trustee has been given the authority to collect money not owed to the estate.

Second, although there are no *in pari delicto* or subrogation concerns in this case, the third concern of *Caplin*—the trustee's suit would not preempt similar suits by other creditors of the corporation—is equally applicable to this case. If the trustee in the

alter ego action; however, its holding was not based exclusively on Section 544(a)(1). *See id.* at 776-84. Moreover, on closer examination, it appears that the court's holding was actually based on Section 544(a)(2), *see id.* at 782, and Sections 541 and 704. *See id.* at 783. As already discussed, however, the alter ego action under Arkansas law cannot be brought by the trustee under Sections 541 and 704. *See* Part A of text, *supra.* Further, we question the validity of *Western World*'s holding based on Section 544(a)(2). Section 544(a)(2) was derived from section 70c of the Bankruptcy Act, and like section 70c, was intended to merely protect the trustee against "quirks of local procedural law," where certain remedial rights flowed to a creditor who had an execution retuned unsatisfied. 4B Collier on Bankruptcy §70.64, at 730-31 (14th ed. 1978). Thus, whenever a procedure was necessary under local law, such as exhausting the legal remedy of obtaining a writ before asserting equitable relief, the trustee would be deemed to have reached that stage in the proceedings. *Id.* at 733. As further noted by Collier, however, this section "lacks real importance because of the general abolition of the distinctions between law and equity." *Id.* The *Western World* court, although noting this background in a footnote related to a different issue in the case, *Western World,* 52 B.R. at 775-76 n.12, cited no Nebraska law requiring this type of procedure before a creditor can bring an alter ego action.

instant case was allowed to pursue and recover on the alter ego cause of action on behalf of Ozark's creditors, there obviously would be questions as to which creditors were bound by the settlement. *See Caplin*, 406 U.S. at 432 & n.22.[13] This is because the trustee is not the real party in interest, and thus does not have the power to bind the creditors to any judgment reached in the litigation. *See, e.g., Clarke v. Chase National Bank*, 137 F.2d 797, 800 (2d Cir.

Additionally, the trustee's argument based on Section 544(b) is weak at most. As already noted, 544(b) is derived from section 70e of the Act and contains little, if any, significant modification. *See* note 11, *supra*. Section 544(b) allows the trustee to avoid "transfers" of the debtor or "obligations" incurred by the debtor that are voidable under applicable (state) law. 11 U.S.C. §544(b). No other authority is granted to the trustee in this subsection. Thus, as noted by one author, Section 544(b) will generally come into play under three scenarios: (1) where a trustee cannot avoid a fraudulent conveyance under 11 U.S.C. §548 because of the permitted period of recovery, and thus has to resort to recovery under the applicable state fraudulent conveyance act; (2) where a trustee wants to recover under the applicable state bulk sales statute; or (3) where there has been an illegal payment of corporate dividends or purchases of stock and the local law allows an unsecured creditor to bring the action. P. Murphy, Creditors' Rights in Bankruptcy §13.05, at 13-6 (1980). In fact, we have found no authority suggesting that a creditor's alter ego claim may be asserted under this subsection.

[13] We note that if Congress had enacted the proposed version of subsection (c) of Section 544, this problem would have been solved. *See* note 9 *supra*, especially proposed subsection (c)(3).

1943); *In re D.H. Overmyer Telecasting Co., Inc.*, 56 B.R. 657, 662-63 (Bankr. N.D. Ohio 1986).

In conclusion, based on congressional intent, as evidenced by the failure to expressly give the trustee standing to bring creditors' causes of action, and based on the concerns in *Caplin,* two of which directly apply to this case, we hold that the Chapter 7 trustee in this case does not have standing under Section 544 of the Code to bring an alter ego cause of action on behalf of the debtor corporation's creditors.

C. 11 U.S.C. § 105 and Equitable Principles.

It is true that Section 105 allows a bankruptcy court to apply equitable principles that are necessary or appropriate in a particular case to carry out the provisions of the Code. *See* 11 U.S.C. § 105. These powers, however, do not include the ability to award equitable relief where the party asserting the cause of action for such relief does not have standing under any other section of the Code. *Cf. Johnson v. First National Bank of Montevideo*, 719 F.2d 270, 273 (8th Cir. 1983) (bankruptcy court's equitable powers may only be exercised in a manner consistent with the provisions of the Code), *cert. denied*, 465 U.S. 1012 (1984). Because no provision of the Code gives the trustee in this case standing to assert the alter ego claim, any equitable relief must be denied. Although this result may seem harsh in light of the bankruptcy

court's clear findings that the corporate structure was abused, an opposite result would contradict the Code's directives.

III. CONCLUSION.

Because the Code does not give the Chapter 7 trustee in this case standing to bring an alter ego action on behalf of the debtor corporation's creditors, the district court's order is affirmed.

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

In re Ozark Restaurant Equipment Co., Inc.

James G. MIXON, Trustee, Plaintiff.

v.

Bruce ANDERSON, Elmer Dale Yancey, Kenneth Eads,
Robert Whiteley and Anderson Cajun's Wharf, Defendants.

James G. MIXON, Trustee, Plaintiff.

v.

ANDERSON CAJUN'S WHARF, Defendant.

James G. MIXON, Trustee, Plaintiff.

v.

Hayden McILROY of McIlroy Bank & Trust,
Ed Yancey, Bruce Anderson and Kenneth Eads, Defendants.

Civ. No. 84-5097.
Bankruptcy No. FA 82-120.
Adv. Nos. 82-882 to 82-844.

United States District Court,
W.D. Arkansas,
Fayetteville Division.

May 22, 1986.

MEMORANDUM OPINION

H. FRANKLIN WATERS, Chief Judge.

A. Background

This is an appeal from a decision of the United States Bankruptcy Court for the Western District of Arkansas in three adversary proceedings consolidated for trial in actions arising out of the bankruptcy of Ozark Restaurant Equipment Co., Inc. Jurisdiction initially rested in bankruptcy court pursuant to 28 U.S.C. §§ 1471 and 1481, 11 U.S.C. § 105, and General Order No. 24 of the United States District Courts for the Eastern and Western Districts of Arkansas. 41 B.R. 476. From a decision in favor of the Trustee in all three proceedings, Bruce Anderson and Anderson Cajun's Wharf, a Little Rock restaurant, and Elmer Dale Yancey and Robert Whiteley bring this appeal pursuant to 28 U.S.C. § 158. This court recognizes the "clearly erroneous" standard of review for factual determinations made by the bankruptcy judge. Bankr.R.813. *See also In*

re Reid, 757 F.2d 230 (10th Cir.1985) (Bankruptcy Amendments of 1984 do not affect standard of review in bankruptcy matters).

In September, 1980, Bruce Anderson and Elmer Dale Yancey purchased a going concern, Ozark Restaurant Equipment Company of Springdale, Arkansas. Each had a 50% interest. The two named Kenneth Eads manager of the company, secured a $100,000 loan from McIlroy Bank, loaned an additional $9,000 from their own funds, and capitalized the business at $1,000.00. Parties expert at appraising the capital needs of a business the size of Ozark, and of restaurant equipment businesses specifically, testified that Ozark was grossly undercapitalized from the beginning.

The business never made a profit. Part of the problem appeared to be that Ozark failed to collect a sufficiently high sales mark-up on deliveries made to Anderson Cajun's Wharf, a restaurant partly owned by Bruce Anderson (51%) and Kenneth Eads (5%) during the relevant time period. Parties expert at the restaurant equipment business estimated that one needs to average a 30% mark-up on a combined line of hard and soft goods to make a profit. In sales to Anderson-related enterprises, specifically Cajun's Wharf, Ozark collected only 7% over cost, and even that small profit was rendered negligible by sales tax (4%) and by the fact that Cajun's paid Ozark invoices late by an average of 77 days at no interest. Items like commissions and freight would further

erode gross profit, although some testimony suggested that salesmen received no commission on sales to Anderson, and that Anderson himself paid the freight.

Accountants traced certain transactions to show that certain sales were made to Anderson enterprises below cost. By way of contrast, evidence was introduced (and not refuted) that sales were made to non-Anderson enterprises at mark-ups between 28% and 90%. The picture emerged through the hearing that Ozark was a captive of Anderson and his enterprises, and that the reason for its existence appeared to be to give Anderson enterprises access to equipment at dealer cost or "just above" because manufacturers like Libby and Hobart would not sell directly to Anderson since they had their own dealers in the Little Rock area.

Bruce Anderson vigorously disputed this characterization of his motives. He testified that a 10% mark-up was normal for a volume buyer like himself, and averred that he bought from Citco, the nation's largest supplier, on those terms, as well as from Don's Bar Supply in Little Rock. Significantly, however, Anderson did not call any witnesses to support his testimony, or offer any documentary proof of his assertions.

Most disturbingly, the Trustee introduced documentary evidence in the form of fraudulent

balance sheets, prepared August 31, 1981, which were evidently used to lull suppliers into sending merchandise to Ozark on credit. These documents admittedly misstated Ozark's position. Ozark workers testified that the balance sheets were prepared simply "in-house." In the words of Whiteley, "It was not the intent to give that to anyone because it was not an official ... we were trying to establish the reflection of the company without having proper expertise in putting together that balance sheet." The Trustee testified that he found numerous copies of this balance sheet in the office, and that one copy was stapled to a telegram from a supplier demanding a recent balance sheet as a condition of selling Ozark equipment on credit.

There can be no doubt but that Bruce Anderson was fully aware of Ozark's failing fortunes at least as early as December 31, 1980, and was aware after that that the company was insolvent and was making no progress towards solvency. It appears from the testimony of accountants that the enterprise never made a monthly profit afterwards. Instead, its net worth steadily declined from minus $1,400.00 in December, 1980, to minus $146,000.00 in September, 1982, a bare twenty months later. Sometime in March, 1981, as Ozark's decline began picking up speed, Bruce Anderson directed that Ozark's mark-up to his enterprises fall from 15% to 10%. Anderson enterprises were responsible for approxi-

mately 23% of all sales made by Ozark during its association with Anderson.

There were numerous instances of self-dealing between Anderson enterprises and the debtor. For example, in July, 1982, when Anderson closed the debtor and filed bankruptcy, Anderson selected certain items from the debtor's inventory to be shipped to another equipment business owned by him. The total value of this merchandise was $20,208.39. No payment was ever made for this. Instead, Anderson tried to prove that it was a swap-out for merchandise earlier consigned by him to the debtor. The bankruptcy court found his proof on this point to be lacking, reviewing the record, it appears nigh non-existent.

B. Trustee's Standing

This appeal poses the difficult question whether a Chapter VII trustee has standing to assert the claim that the debtor corporation was an *alter ego* of third parties. Although neither side raised the question specifically, we are obliged to examine the trustee's standing, as a matter of the case-or-controversy requirement associated with Article III. *Juidice v. Vail,* 430 U.S. 327, 331-32, 97 S.Ct. 1211, 1215, 51 L.Ed.2d 376 (1977).

In *Caplin v. Marine Midland Grace Trust Co.,* 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972),

the court held that a reorganization trustee lacked standing to assert creditors' causes of action against third parties. This court initially reads *Caplin* restrictively, as relevant only to reorganization proceedings brought under pre-Code bankruptcy law. Such a reading is warranted by *Caplin's* suggestion that the standing issue was "capable of resolution by explicit congressional action." *Id.* at 422, 92 S.Ct. at 1682. Six years later, Congress overhauled the bankruptcy laws.

In addition, the *Caplin* opinion is flavored with a suggestion that a reorganization trustee's powers did not extend as far as those of a liquidation trustee. This circumstance, too, impels the court to apply *Caplin* cautiously. Judicial economy is ill-served when an appellate court, *sua sponte*, dismisses a fully-litigated case on a standing issue.

[1,2] Congress does not appear to have explicitly empowered the trustee to bring an *alter ego* action on behalf of creditors. His is not a roving commission. His position does not empower him to bring suits personal to a creditor. *Melamed v. Lake County National Bank,* 727 F.2d 1399 (7th Cir.1984). An *alter ego* action is personal to creditors, and may not in fact be filed by a corporation. *See* 18 Am.Jur.2d *Corporations* § 46. This rule finds inferential support in Arkansas, where in *Shipp v. Bell,* 256 Ark. 89, 505 S.W.2d 509 (1974), a party was estopped to *deny* its own corporate status.

Congress has specifically enumerated the trustee's powers and duties, the principal one being to collect and liquidate the property of the estate. 11 U.S.C. § 704. Property of the estate is defined as all legal and equitable interests the debtor has in property. 11 U.S.C. § 541. That formula includes choses in action. 4 Collier's On Bankruptcy § 541[01](15th ed. 1979).

In addition, Congress has given the trustee rights of action which the debtor could not have maintained under common law, *i.e.*, to void fraudulent conveyances and preferences. 11 U.S.C. § 547, 548. A debtor has no right at common law to rescind a fraudulent conveyance. *McCune v. Brown*, 8 Ark.App. 51, 548 S.W.2d 811 (1983). Congress empowers the trustee to do so. Similarly, at common law neither the debtor nor an unfavored creditor could sue to void a preference. *Baker v. Gowers*, 180 Ark. 1110, 25 S.W.2d 438 (1930). Under the Code, a trustee can. Congress has not otherwise provided that the trustee might bring a creditor's action against third parties, even under an *alter ego* theory. Particularly after *Caplin*, this is disturbing.

We take this circumstance not to mean that the new Code prohibits the trustee from suing, but merely that Congress has left us where it found us, and that we must make our way by our own lights. *Caplin* enjoins us in such a case to "... resolve [the

question of a trustee's standing] by examining the nature of [the bankruptcy proceeding), the role of the trustee in [the proceeding] and the way in which standing to sue on behalf of [creditors] would affect or change that role." 406 U.S. at 422, 92 S.Ct. at 1682.

In deciding *Caplin*, the court noted that in "contradistinction" to a bankruptcy proceeding where liquidation of a corporation and distribution of its assets is the goal, a Chapter X proceeding is for purposes of rehabilitation and reorganization. In all candor, for present purposes, this appears to be a contradistinction without a difference. If a trustee is appointed to rehabilitate a corporation, it would be obviously beneficial to the corporation to require parties actually causing or contributing to injuries to creditors to pay up and thereby lighten the load of debt to be serviced by the reorganized entity. If this vital interest does not suffice to give a reorganization trustee standing to sue for wrongs done to creditors, then the court is at a loss to understand why a trustee of a defunct entity has a more forcible argument for the exercise of such powers. At least in the former instance, an interest of the entity is being addressed. In a Chapter VII case, *only* creditor interests are being asserted. The court does not intend by this observation to disparage those interests, only to say that since such is the case, the creditors and the creditors alone should pursue them. One of the major functions of the standing requirement is to assure

vigor and adversity in the prosecution of a claim. "Third parties themselves usually will be the best proponent of their own rights." *Singleton v. Wulff,* 428 U.S. 106, 114, 96 S.Ct. 2868, 2874, 49 L.Ed.2d 826 (1976).

It bears remarking in this context that a corporation in a Chapter VII proceeding is not eligible for a discharge, as an individual is. 11 U.S.C. § 727(a)(1). Practically speaking, the corporation emerges from a Chapter VII proceeding with no future existence, and no interest at all in retiring obligations which remain undischarged after the liquidation of its assets. If it should ever resume business, its capital would be immediately subject to the claims of creditors. Congress has so explicitly provided in order that trafficking in bankrupt corporations and partnerships be deterred. 4 Collier On Bankruptcy § 727.01[2]. Whereas a reorganized corporation has an interest in retiring obligations, a Chapter VII corporation does not. This circumstance even more clearly identifies the interest of an *alter ego* proceeding as one unique to creditors, not one common to the entity and its creditors.

[3-5] A cumulation of detail on the nature of a Chapter VII corporate bankruptcy proceeding, as this one is, impels one to the conclusion that the *Caplin* standing rule must apply a *fortiori* to our case. If necessary, a further reason suggests itself why this must be so. In the plenitude of cases brought by

corporations under Chapter VII, a number of debtors may actually have some assets available to apply to the claims of unsecured creditors, or the trustee may be successful in avoiding liens, recovering preferences, or attacking transfers in fraud of creditors, and thereby augmenting the estate for the benefit of the unsecured creditors. If the trustee determines that suit might lie on an *alter ego* theory, he must perforce use assets of the corporation to prove his point. Of course, this is true regardless of the nature of the proceeding he undertakes. The critical difference is this: *alter ego* proceedings are not favored in the law. One must generally show that the entity was used in fraud of third parties. *Cf. Green v. Equitable Powder Mfg. Co.*, 95 F.Supp. 127, 131 (W.D.Ark.1951). In Arkansas, fraud must be proved clearly and convincingly, and is never presumed. *Rice v. Rice*, 125 F.Supp. 900 (W.D.Ark.1955). An *alter ego* finding, accordingly, is one which is to be made with great caution. *Plant v. Cameron Feed Mills, Inc.* 228 Ark.607, 309 S.W.2d 312 (1958). A Chapter VII trustee suing on an *alter ego* theory puts creditors' funds at risk in a speculative venture, or one which requires a higher-than-ordinary standard of proof, to obtain a remedy which must be sparingly ordered. The court strongly feels that the creditors themselves are in the best position to determine whether the gamble should be taken, and in by far the best position to fund one.

The role of the trustee in liquidation, the second

prong of *Caplin's* three-part test, *supra*, is defined by 11 U.S.C. § 704. It includes the duty to collect and reduce to money the property *of the estate* for which such trustee serves. 11 U.S.C. § 704(1). Property of the estate is defined to include the debtor's "legal or equitable interests ... in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). We have previously discussed that the debtor has no right to file an *alter ego* action. Such rights have historically belonged to creditors alone, to be enforced by a creditors' bill in equity. 3 R. Clark, *The Law and Practice of Receivers* §§ 795, 796(a), 802 (3rd ed. 1959).

Admittedly, *Henderson v. Rounds & Porter Lumber Co.*, 99 F.Supp. 376 (W.D.Ark.1951), offers some support for the Trustee's position in this case. There, the trustee *joined* an *alter ego* proceeding brought by a creditor. The creditor has standing to bring such an action, there was never a pure Article III question involved in *Henderson*. A close reading of that opinion instantly reveals that, if anything, the decision actually attacks the proposition that the trustee, acting alone, has any power to bring an *alter ego* action. First, the defendant argued that *the creditor* had no right to bring the suit, and that *only* the trustee was so empowered. To this the court responded that the trustee has no power to enforce rights running solely to creditors. *Id.* at 380.

Second, the court noted that the trustee

succeeds to any right the corporation has against its directors or shareholders for misconduct. Clearly, however, this right extends only to the limits of the misconduct. It does not extend to all debts of the corporation, some of which may arise because of bad business climate or managerial decisions immunized under the "business judgment rule."

An *alter ego* action, however, charges the defendants with *all* the losses of the business, not just those occasioned by their fraud. A creditor in such a case essentially declares, "I transacted with Ozark, but in reality with Anderson because Ozark was nothing more than Anderson." If that be the case, there is no need to show that the creditor was defrauded by a specifically deceitful misrepresentation. The equity court investigates the affairs of the debtor and the third party to determine whether the third party has properly honored the debtor's status as a distinct entity. If he has, giving him the benefit of the doubt, then the equity court will deny the creditor's bill, recognizing that a very valid aim of incorporation is the limitation of personal liability to the capital invested in the enterprise. If, however, he has abused the corporate form, then the question whether the creditor is specifically aggrieved by an act of the shareholder is irrelevant. The shareholder is liable because of an abuse of the form, sometimes for trifles such as for failing to pay a franchise tax to the state. *See, e.g., Moore v. Rommel,* 223 Ark. 989, 350 S.W.2d 190 (1961).

Third, *Henderson* acknowledged that the trustee would ordinarily be limited to the amounts wrongfully appropriated. The court acknowledged that the *claims of the plaintiffs* were not tried on that basis, noting specifically that under state law creditors did have the right to seek the relief pursued in the case. *Id., citing Rounds & Porter Lumber Co., v. Burns,* 216 Ark. 288, 225 S.W.2d 1(1949).

Finally, having at least one party properly able to present an *alter ego* claim before it, *Henderson* proceeded to allow the trustee to assert to belonging to the estate; and as an additional matter, the court permitted the trustee to assert the claims of absent creditors "for the benefit of the estate." As Blumberg, *The Law of Corporate Groups: Bankruptcy Law*, (Little Brown 1985) § 15.18, freely acknowledges, 'The [*Henderson*] court did not trouble to cite any authority for its unusual action."

What alternative, however, did the *Henderson* court, sitting as a chancellor, have? To have forbidden the trustee to act would have allowed the individual creditors to take a judgment for 100% of their claims. Other creditors, subsequently suing, stood the chance of acquiring only a fraction of their own. The judgment against Rounds & Porter Lumber, then, would be in the nature of a preference itself!

It is important to note that the federal judge in *Rounds & Porter* sat as a chancellor in diversity. At that time, Arkansas maintained separate courts of law and equity, whose procedures were not merged. *See* Note, 24 Ark.L.Rev. 162, 176 n. 54. Under the doctrine of virtual representation, an equity court would order class-wide relief in a decree, even though only a single party brought the action. It was not necessary for the party to be named as a class member of a class, so long as it appeared that he was in fact a member of a class, and sued or defended the action along class principles. *See, e.g., Ussery v. Darrow,* 238 Ala.67, 188 So. 885, 890, 891(1939). In *District No. 21 United Mine Workers of America v. Bourland,* 169 Ark. 796, 806, 277 S.W. 546 (1925), the court said, "A creditors bill has always been one of the favorite subjects of equity jurisprudence, and in a case where the setting aside of a fraudulent conveyance is the primary object of the bill, equity, having required jurisdiction of the case for that purpose, will settle all the issues involved and afford complete relief."

Judge Miller, in *Henderson v. Rounds & Porter Lumber Co., supra,* sat as a chancellor in diversity and fashioned a decree to settle all issues and obtain complete relief. He could have appointed a creditor as representative of the class and probably "should have." That creditor would have been impressed with a trust with respect to the fund, and would have therefore had all the worst of the bargain since he

Judge Miller, in *Henderson v. Rounds & Porter Lumber Co., supra,* sat as a chancellor in diversity and fashioned a decree to settle all issues and obtain complete relief. He could have appointed a creditor as representative of the class and probably "should have." That creditor would have been impressed with a trust with respect to the fund, and would have therefore had all the worst of the bargain since he never sued in a representative capacity, and probably had no interest at all in any matter other than to get his own judgment and conclude his involvement in the action.

Being of an eminently and admirably practical turn of mind, Judge Miller selected the one party before him who already was impressed with a trust, namely the bankruptcy trustee, and designated him as representative of other creditors under former section 70(e), an analog to present section 544(b) of the Code. The hand of equity is quicker than the eye of law. Section 70(c) followed the rule of *Moore v. Bay*, 284 U.S. 4, 52 S.Ct. 3, 76 L.Ed.133 (1931), and gave the trustee the power to avoid any transfer of an interest of the debtor voidable under state law by a creditor. An *alter ego* proceeding does not invalidate the transfer of an interest — it imputes the obligations of one party to another regardless of any "transfer." The creditor who dealt with "the shell" has a personal right which is not shared in any sense by the trustee of "the shell," and creditors alone may vindicate that right.

Where *Caplin* has called directly into question a trustee's standing, and that standing was not broadened by Congress despite the Supreme Court's direct invitation to them to act, this court deems it necessary to re-examine *Henderson v. Rounds & Porter Lumber Co., supra.* The *Henderson* court handled the case much as an Arkansas chancellor would, saying that he would proceed to adjudicate all claims because he was "not convinced" that the trustee was not empowered to represent their interests." 99 F.Supp. at 380. Of course, the question is ordinarily put the other way around, and in the federal system the plaintiff is ordinarily obliged to prove his standing, to a point where a court is satisfied that he can bring his suit.

Henderson is *sui generis.* It took what has been described as unusual action, but one which was probably not unusual for Arkansas practice in those days, before the procedures of law and equity were officially unitized. Now that the state courts have unitized their procedures, Arkansas Rules of Civil Procedures, Rules (ARCP) 1, 2 and 81, and have propounded a class action rules that comports more fully with federal notions of due process *via* a notice requirement, ARCP Rule 23(d), a chancellor does not have the liberty formerly enjoyed by him to shape relief for absent parties who were "virtually represented" in the equity proceeding. That is, it is doubtful that Judge Miller today would shape relief as he did thirty-five years ago, because Arkansas

chancellors now would not do so. It is especially improbable that he would have done so in an original action, ancillary to a bankruptcy proceeding whose organic law does not give its trustees broad standing powers.

In short, nothing in *Henderson* suggests that the trustee has standing to bring an *alter ego* proceeding by himself. Nothing in the new Code defines the trustee's duties to embrace the collection of property the estate never owned. When the trustee sues, he sues in the name of the estate. The *alter ego* action by a trustee fails an ontological test, since he essentially asks a declaration that the entity does not exist, despite the fact that he has previously administered assets as if the entity owned them.

Finally, the third part of the *Caplin* inquiry asks whether there is any way in which giving the trustee standing to sue on behalf of creditors would change or affect his role as a liquidator. In a Chapter VII proceeding, giving him such standing creates a situation rife with conflicts, conflicts which can only be resolved if the creditors alone are recognized as proper parties plaintiff in an *alter ego* proceeding.

One of the duties of a Chapter VII trustee is to "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. § 704(4). One of his duties, then, is to whittle the number of unsecured claims against the estate. If, however, a

third party exists who is "good" for the claims, the trustee has no motive to pursue his duties under § 704(4). In fact, given that his compensation depends on the size of the estate, he actually has an interest in allowing as many claims as possible so that the recovery, and his compensation, is as large as possible.

To the extent that his interest becomes personally adverse to the third party, by allowing marginal claims which might be disallowed at his instance, it becomes adverse to "true creditors" whose interest in the third party's funds may be diluted below a dollar-for-dollar recovery if the trustee's conflicting interests influence him to forbear challenging marginal claims against the estate. These creditors, in a suit where the trustee acts alone, are unrepresented. They must depend on one having an adverse interest — the third party — to make the kinds of objections the law requires the trustee to make. [It should be noted in this connection that the estate in a Chapter VII case is deemed to have no standing to object to the allowance of a claim unless to do so would result in a surplus distributable to the debtor. *Kapp v. Naturelle, Inc.*, 611 F.2d 703, 707 (8th Cir.1979).]

C. Conclusions

[6] We accordingly decide then that a Chapter VII trustee liquidating a corporation has no standing

on his own to bring an *alter ego* action. He does have power, of course, to avoid preferences and fraudulent transfers. It appears that the trustee correctly found that the $20,208.39 worth of merchandise shipped to Anderson's enterprises was a transfer in fraud of creditors, and the bankruptcy court's judgment will be affirmed in that particular. The bankruptcy court did not find that the "low mark-ups" accorded Anderson and his enterprises were fraudulent transfers as they are defined in the Code, or preferences. This issue will be remanded to the bankruptcy court for further findings. It is unclear to the court whether these transfers were "on account of an antecedent debt" as required by § 547(b)(2). It is also unclear whether property transferred to a third party is fraudulent within the scope of § 548(a)(2)(A) where the property was sold at 80% of retail value, and above cost. The bankruptcy court, in giving the Trustee judgment for the entire amount of the unsecured debt, has not particularized its findings. The case is therefore remanded for further proceedings consistent with this opinion.

In re OZARK RESTAURANT EQUIPMENT CO., INC., Debtor.

James G. MIXON, Trustee, Plaintiff

v.

Bruce ANDERSON, Elmer Dale Yancey, Kenneth Eads, Robert Whiteley and Anderson Cajun's Wharf, Defendants.

James G. MIXON, Trustee, Plaintiff

v.

ANDERSON'S CAJUN'S WHARF, Defendant.

James G. MIXON, Trustee, Plaintiff,

v.

HAYDEN McILROY OF McILROY BANK & TRUST; Ed Yancey, Bruce Anderson and Kenneth Eads, Defendants.
Bankruptcy No. FA 82-120.
Adv. Nos. AP 82-882 to 82-884.

United States Bankruptcy Court,
W.D. Arkansas,
Fayetteville Division.

March 21, 1984.

ORDER

CHARLES W. BAKER, Bankruptcy Judge.

Before the Court are three Adversary Proceedings consolidated for trial. The hearing began on October 14, 1983. After adjournment on that date the balance of the hearing was conducted in Little Rock on November 18, 1983. Hon. James G. Mixon, Trustee, was represented by Hon. F.H. Martin. Hon. Marshall Dale Evans represented Kenneth Eads. Hon. Truman H. Smith and Hon. Raymond C. Smith represented Anderson Cajun's Wharf. The Trustee presented testimony from Carol Brooks, Elmer Dale Yancey, James Tandy, Bruce Anderson, Ron Berry, Kenneth Eads, Robert Whiteley, James G. Mixon, George Kitchens and introduced fifty-two (52) exhibits. Anderson Cajun's Wharf presented the testimony of Bruce Anderson and introduced two (2) exhibits.

The Court has jurisdiction over this dispute pursuant to 28 U.S.C. §§ 1471 and 1481, 11 U.S.C. § 105, and General Order No. 24 of the United States District Court for the Eastern and Western Districts of Arkansas.

The Court, having researched the issues

presented and being fully advised in the premises, makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. "Anderson-related entities" hereinafter will be taken to mean Anderson Cajun's Wharf in Little Rock, Cajun's Wharf in Nashville, Cajun's Wharf in Knoxville, Gonzales and Gertrude's, Port City Equipment Co., and Port City Seafood Co. Bruce Anderson owned 50% or more of the stock in each of these in 1980.

2. Anderson Cajun's Wharf, Inc., operated Cajun's Wharf restaurants in Little Rock, Nashville, and Knoxville. Bruce Anderson was the Chief executive officer of Anderson Cajun's Wharf, Inc., and Gonzales and Gertrude's. The latter is also a restaurant.

3. Bruce Anderson was a 50% shareholder and director of the debtor, Ozark Equipment Co., Inc. Elmer Dale Yancey was also a 50% shareholder, director, and officer of the debtor. Kenneth Eads was a director and president of the debtor.

4. Port City Equipment Co., is a subsidiary of Anderson Cajun's Wharf, Inc., which sold restaurant equipment to other Anderson-related entities.

5. The debtor conducted the same type business as Port City Equipment Co. The debtor also sold its equipment to Anderson-related entities, including Port City Equipment. Port City Equipment, in fact, was the debtor's biggest account.

6. The debtor from the beginning was grossly undercapitalized. At the outset, it had liabilities of $109,000 and capital of $1,000.

7. The debtor never made a true profit and continually throughout its existence showed a negative net worth. Specifically, the debtor's negative net worth grew from a negative $1,400 on December 31, 1980 to a negative $146,000 on September 1, 1982.

8. Although normal profit margins or "markups" would, necessarily, in a profitable business comparable to the debtor's, be 25% to 30%, the debtor sold in volume to Anderson-related entities at 10% to 15% markups. Although the Court heard no evidence on the *average* markups on sales to non-Anderson-related entities, two individual sales to other customers were made at markups of 29.57% and 10.03%.

9. Bruce Anderson directed the debtor to reduce the markup from 15% to 10% in sales to his entities. Although it is impossible to determine from the

evidence exactly when this occurred, from March 1981 until the debtor closed its doors, the markup was 10%.

10. Certain manufacturers, especially Libby Glass, would not sell directly to Port City Equipment. They would sell direct to the debtor, who, in turn, sold to Port City Equipment at cost plus 10%.

11. Bruce Anderson was aware of the debtor's financial condition. He clearly was aware of its status when the company was formed with $1,000 operating capital ($500 of which was contributed to him) and $109,000 in liabilities, most of which consisted of a note to the bank guaranteed by Anderson and Yancey. Subsequently, David Walker apprised Anderson, upon receipt of the income statement from the four months ending December 31, 1980, of the company's negative net worth. Anderson was aware of continuing losses after that time.

12. Robert Whiteley, a business consultant, was hired by Anderson to help the debtor cut costs, check sales, and deal with accounts payable. From the time he joined the debtor in March of 1981, Whiteley communicated the debtor's bleak financial condition to Anderson and Walker.

13. Bruce Anderson ultimately controlled the debtor. The president, Kenneth Eads, ran the

debtor's daily operations. David Walker, comptroller for Anderson Cajun's Wharf, Inc., served as liaison between Eads and Anderson. For example, if Eads and Robert Whiteley disagreed over a policy, they discussed it with Walker and/or Anderson.

14. In July, 1982 Bruce Anderson closed the debtor and decided to file for relief under the United States Bankruptcy Code.

15. Also in July, 1982 Bruce Anderson selected certain items from the debtor's inventory to be shipped to Port City Equipment. The total value of this equipment was $20,208.39. The debtor was never paid for this transfer.

16. Anderson-related entities purchased equipment from the debtor on credit. Payments for these purchases averaged 77 days after the date of purchase. No interest was charged or collected on these outstanding accounts.

17. Robert Whiteley and Kenneth Eads took out personal loans in order to contribute $5,000 each to the debtor. On at least three different occasions Whiteley and Eads drew money from the debtor to pay themselves back for these $5,000 contributions.

18. The debtor's net worth on the following dates was:

12-31-80	$(1,400)
4-30-81	(14,043)
4-30-82	(80,000)
9-01-82	(146,000)

19. The parties stipulated that the debtor made the following payments to McIlroy Bank on the following dates:

9-09-81	$ 4,970.52
10-09-81	2,485.26
11-02-81	2,485.26
12-24-81	2,485.26
1-08-82	2,485.26
2-19-82	2,485.26
4-23-82	2,485.26
5-10-82	2,641.49

20. In sales to Port City Equipment the debtor (a) at times did not bill Port City Equipment; (b) sold to Port City Equipment at a loss; (c) at times utilized a gross markup of 7%; and (d) sometimes used no markup at all.

21. The debtor kept no separate accounts receivable records for the various Anderson-related entities. All sales to Anderson-related entities were entered on the Port City Equipment accounts receivable ledger.

From the above and foregoing findings of fact, the Court makes the following conclusions of law:

1. 11 U.S.C. § 542 (b) states: Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the Trustee, except to the extent that such debt may be offset under § 553 of this title against a claim against the debtor.

(1) 2. Based on this section of the Code, the Court finds Port City Equipment liable in the amount of $20,208.39 for goods shipped to it by the debtor in July, 1982, for which payment was never received by this debtor.

3. Testimony was heard regarding a consignment of equipment from Port City Equipment Co. to the debtor. This testimony was insufficient as to the date of such alleged consignment, the terms thereof, and the value of the consigned items to form the basis of a setoff under §553. Furthermore, this alleged debt is not listed in the debtor's schedules, Port City Equipment has not filed a proof of claim, nor could Port City Equipment produce documentary evidence at trial substantiating this debt. Defendant's Exhibit 1 purports to represent a list of items consigned. The debtor, however, denies such a consignment.

Defendant's Exhibit 1 is not dated. It is addressed to no one in particular. It is not accompanied by a cover letter or memo setting out the terms of the alleged consignment. Furthermore, there is a significant conflict between the value assessed on the Exhibit ($15,000) and the value assessed by Bruce Anderson in his testimony ($10,000-$12,000). Suffice it to say, the Court is not convinced Defendant's Exhibit 1 is what Mr. Anderson claims it to be.

4. 11 U.S.C. § 547(b) states: Except as provided in subsection (c) of this section, the Trustee may avoid any transfer of property of the debtor (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made (B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer (i) was an insider; and (ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer, and that enables such creditor to receive more than such creditor would receive if (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(2) 5. Based on the criteria found in § 547, the Court finds the seven payments totaling $24,035.82, made by the debtor to McIlroy Bank within a year of

the filing of the petition in bankruptcy, to be preferential transfers, which can be recovered by the Trustee. The one year time period is applicable due to the fact that Anderson and Yancey were insiders and also were the creditors who benefited from payments to McIlroy on a loan they had guaranteed. See, *Cooper Petroleum Co. v. Hart,* 379 F.2d 777 (5th Cir.1979); *Kobusch v. Hand,* 156 F. 660 (1907), *cert. denied*, 209 U.S. 547, 28 S.Ct. 758, 52 L.Ed. 720 (1908). Because of the personal guaranties by Bruce Anderson and Elmer Dale Yancey on the original $100,000 note the Bank is entitled to judgment for $24,035.82 over against the guarantors.

6. Furthermore, because the original loan is in default, the guarantors, Anderson and Yancey, are liable to McIlroy Bank for the balance due on the note, which, as far as the Court is able to determine, is $93,245.20.

(3-8) 7. The Court now turns to the allegation, raised in the Trustee's complaint in AP 82-882, that the defendants abused the corporate entity of Ozark Restaurant Equipment Co., Inc. to such an extent that they should be held personally liable for the debts of the debtor herein. The Court finds that the debtor, Ozark Restaurant Equipment Co., Inc., was so controlled and manipulated by and for the benefit of Bruce Anderson and his various subsidiaries, that the named defendants herein, Bruce Anderson, Elmer Dale Yancey, Kenneth Eads and Robert

Whiteley, should be liable, jointly and severally in the sum of $126,908.18. The Court so finds for the following reasons:

A. An obvious inadequacy of capital, "measured by the nature and magnitude of the corporate undertaking," is an important factor to be considered in deciding whether to deny stockholders their defense of limited liability. *Anderson v. Abbott,* 321 U.S. 349, 64 S.Ct. 531, 88 L.Ed. 793 (1944). Here, the $1,000 investment by Yancey and Anderson weighed against liabilities (initially) of $109, resulted in the debtor's being insolvent from its inception. Where capitalization has been inadequate, courts have been inclined to hold owners of the corporation personally liable. *Everett v. Trans-World Airlines,* 298 F.Supp. 1099 (1969). See also *Minton v. Cavaney,* 56 Cal.2nd 576 15 Cal.Rptr. 641, 364 P2d 473 (1961); *Markow v. Alcock,* 356 F.2d 194 (5th Cir.1966); *Francis O. Day Co. v. Sharpiro,* 105 U.S. App.D.C. 392, 267 F.2d 669 (1959); *Stone v. Eacho,* 127 F.2d 284 (4th Cir.1942); *Henderson v. Rounds and Porter Lumber Co.*, 99 F.Supp. 376 (1951).

B. The directors and shareholders of Anderson-related entities, Bruce Anderson and Elmer Dale Yancey, are also the sole shareholders of the debtor. As such, they were under a fiduciary obligation to protect the entire community of interests in the debtor corporation—creditors as well as stockholders. *Pepper v. Litton,* 308 U.S. 295, 60 S.Ct. 238, 84

L.Ed. 281 (1939). *Francis v. United Jersey Bank*, 87 N.J. 15, 432 A.2d 814 (1981). It has long been the law in Arkansas that any failure of a director to exercise diligence or good faith which results in loss to a stockholder or creditor, entitles such stockholder or creditor to require the directors whose negligence have caused the loss to pay. In other words, the director is liable for such loss to stockholders and creditors. *Smith v. Citation Mfg. Co.*, 266 Ark. 591, 587 S.W.2d 39 (1979); *Sternberg v. Blaine*, 179 Ark. 448, 17 S.W.2d 286, 288 (1929); *Bank of Commerce v. Goolsby*, 129 Ark. 416, 196 S.W. 803 (1917). There is an even greater fiduciary duty on one who is both a director and an officer in a company. *Raines v. Toney*, 228 Ark. 1170, 313 S.W.2d 802 (1958).

C. The upshot of the conclusions stated above, i.e. that the debtor was, from the beginning, grossly undercapitalized and that Anderson and Yancey owed a fiduciary duty to creditors of the debtor, is that the debtor, Ozark Restaurant Equipment Co., Inc. became the mere instrument of Port City Equipment, and thus, other Anderson-controlled entities. *Steven v. Roscoe Turner Aeronautical Corporation*, 324 F.2d 157 (7th Cir.1963). The Bankruptcy Court, being a court of equity, looks beyond the mere outward shell to be the parties in interest beyond the fictions of law and corporate forms to the purposes and officers who are identified with that purpose. *McCaskill Co. v. U.S.*, 216 U.S. 504, 30 S.Ct. 386, 54 L.Ed. 56 (1910). Here,

Anderson-related entities profited from the debtor while the debtor continually operated at increasing deficits. This course of conduct was exhibited by the sales from the debtor to Port City Equipment at low markups or no markups at all; by the credit arrangement with the debtor enjoyed by Anderson-related entities, i.e., they paid no interest on their accounts payable; by severely inadequate capitalization; and by preferential payments to McIlroy Bank. The disregard for the corporate entity of the debtor is illustrated by its failure to keep adequate books and records; the distribution of false financial statements; total failure to pay franchise, withholding and income taxes, and the failure to hold regular meetings of the shareholders and directors.

(9) Certainly, the common owners of Port City and the debtor are not liable for the debts of the latter merely because of the common ownership. It is only when the privilege of transacting business in corporate form has been illegally abused to the injury of a third person that the corporate entities should be disregarded. *Rounds & Porter Lumber Co. v. Burns*, 216 Ark. 288, 225 S.W.2d 1 (1949). *Rounds & Porter Lumber Co., supra,* embodies the law in Arkansas regarding abuse of the corporate entity. The facts in that case are similar to the facts herein. In *Rounds, supra*, the Court allowed a creditor a judgment directly against the parent corporation for wrongful manipulation of the subsidiary to the parent's advantage at the expense of that creditor. Specifical-

ly, the court there found that products of the subsidiary were sold to the parent at a substantially lower price than that charged in sales to third persons. As here, the general manager of the subsidiary in *Rounds, supra*, protested that a profit could not be generated with such discounts for the parent corporation. The Court finds, as did the court in *Rounds, supra*, that "One of the surest indications of abuse...is the fact that the executives of the subsidiary, instead of acting independently in its interest, take their orders from the parent corporation in the latter's interest." 225 S.W.2d at 3.

In sum, in AP 82-883, the Court awards judgment to the Trustee against Anderson Cajun's Wharf, Inc. in the amount of $20,208.39. In AP 82-884 the Court finds for the Trustee in the amount of $24,035.82. These preferential payments were paid to McIlroy Bank on a loan guaranteed by Yancey and Anderson. Ultimately, the liability in AP 82-884 rests upon Elmer Dale Yancey and Bruce Anderson. Also, in AP 82-884, McIlroy Bank has cross-claimed for the balance due on their original promissory note. The Court will also enter judgment against the guarantors, Anderson and Yancey, for the amount, which is $93,245.20. Finally, in AP 82-882, the Court enters judgment for the Trustee in the amount of $136,653.38, or the amount of unsecured debt listed in the petition, against Bruce Anderson, Elmer Dale Yancey, Kenneth Eads, and Robert Whiteley.

SO ORDERED.

APPENDIX B

STATUTES INVOLVED

11 U.S.C. § 541

§ 541. Property of the estate.

(a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the

debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under Section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor; or

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commence-

ment of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. 544

§544. Trustee as lien creditor and as successor to certain creditors and purchasers.

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

(b) The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C. §704

§704. Duties of trustee.

The trustee shall—

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in § 521(2)(B) of this title;

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to the operated, file with the court, *with the United States trustee,* and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as *the United States trustee or* the court requires; and

(9) make a final report and file a final account of the administration of the estate with the court *and with the United States trustee.*

APPENDIX C

United States Court of Appeals

For the Eighth Circuit

Judgment

No. 86-1729WA

In Re: Ozark Restaurant Equipment Co., Inc.,
James G. Mixon, Trustee, Appellant
v.
Bruce Anderson, et al., Appellees

Appeal from the United States District Court for the Western District of Arkansas.

This appeal from the United States District Court was submitted on the record of the said district court, briefs of the parties and was argued by counsel.

Upon consideration of the premises, it is hereby ordered and adjudged that the judgment of the

district court is affirmed in accordance with the opinion of this Court.

April 14, 1987

A true copy:

ATTEST: /s/ Robert D. St. Vrain

CLERK, U. S. COURT OF APPEALS, 8TH CIRCUIT

MANDATE ISSUED: MAY 5, 1987

In the United States District Court
Western District of Arkansas
Fayetteville Division

Civil No. 84-5097

In Re: Ozark Restaurant Equipment Co., Inc.,
James G. Mixon, Trustee — Plaintiff
v.
Bruce Anderson, Elmer Dale Yancey,
Kenneth Eads, Robert Whiteley and
Anderson Cajun's Wharf — Defendants

James G. Mixon, Trustee — Plaintiff
v.
Anderson Cajun's Wharf — Defendant

United States Bankruptcy Court
For the Western District of Arkansas

RE: Ozark Restaurant Equipment Co., Inc.
James G. Mixon, Trustee — Plaintiff
v.
Anderson Cajun's Wharf — Defendant

Adversary Proceeding No. 82-883

JUDGMENT

This proceeding having come on for trial or hearing before the court, the Honorable Charles W. Baker, United States Bankruptcy Judge, presiding, and the issues having been duly tried or heard and a decision having been rendered.

IT IS ORDERED AND ADJUDGED:
That the Trustee have judgment from Anderson Cajun's Wharf in the amount of $20,208.39.

/s/Peggy Carroll
Clerk of Bankruptcy Court
By: /s/Susan Dean
Deputy Clerk

(Seal of the U.S. Bankruptcy Court)
Date of issuance: 6-27-85

United States Bankruptcy Court
For the Western District of Arkansas

RE: Ozark Restaurant Equipment Co., Inc.
James G. Mixon, Trustee Plaintiff
v.
Bruce Anderson, Ed Yancey, Kenneth Eads and McIlroy Bank and Trust Defendant

Adversary Proceeding No. AP 82-884

JUDGMENT

This proceeding having come on for trial or hearing before the court, the Honorable Charles W. Baker, United States Bankruptcy Judge, presiding, and the issues having been duly tried or heard and a decision having been rendered.

IT IS ORDERED AND ADJUDGED:

That the Trustee have judgment against McIlroy Bank and Trust in amount of $24,035.82; that McIlroy Bank & Trust have judgment against Bruce Anderson and Elmer Dale Yancey in the sum of $93,245.20.

/s/Peggy Carroll
Clerk of Bankruptcy Court
By: /s/Susan Dean
Deputy Clerk

(Seal of the U.S. Bankruptcy Court)
Date of issuance: 6-27-85

United States Bankruptcy Court
For the Western District of Arkansas

RE: Ozark Restaurant Equipment Co., Inc.
James G. Mixon, Trustee — Plaintiff
v.
Anderson Cajun's Wharf — Defendant

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United States Bankruptcy Court
For the Western District of Arkansas

RE: Ozark Restaurant Equipment Co., Inc.
James G. Mixon, Trustee Plaintiff
v.
Bruce Anderson, Ed Yancey, Kenneth Eads and McIlroy Bank and Trust Defendant

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Clerk of Bankruptcy Court
By: /s/Susan Dean
Deputy Clerk

(Seal of the U.S. Bankruptcy Court)
Date of issuance: 6-27-85

Supreme Court, U.S.
FILED
AUG 14 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-71

In the Supreme Court of the United States

October Term, 1987

In Re: Ozark Restaurant
Equipment Co., Inc.
Jill R. Jacoway,
Successor Trustee ..... *Petitioner*

V.

Bruce Anderson, Elmer Dale
Yancey, Kenneth Eads,
Robert Whiteley and
Anderson's Cajun Wharf ..... *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF IN OPPOSITION FOR THE RESPONDENT

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Attorney for Respondents
Bruce Anderson
Elmer Dale Yancey
Anderson's Cajun Wharf

QUESTION PRESENTED

DOES A BANKRUPTCY TRUSTEE IN A CHAPTER 7 LIQUIDATION OF A DEBTOR CORPORATION HAVE STANDING TO BRING AN ALTER EGO ACTION SOLELY ON HER OWN INITIATIVE AGAINST THE FORMER SHAREHOLDERS AND DIRECTORS OF THE DEBTOR CORPORATION?

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No. 87-71

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October Term, 1987

In Re: Ozark Restaurant
Equipment Co., Inc.
Jill R. Jacoway,
Successor Trustee ..... *Petitioner*

V.

Bruce Anderson, Elmer Dale
Yancey, Kenneth Eads,
Robert Whiteley and
Anderson's Cajun Wharf ..... *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF IN OPPOSITION
FOR THE RESPONDENT

STATEMENT OF THE CASE

The respondent accepts the petitioner's statement of the case as far as the basic procedural accuracy is concerned. However, there are several factual disputes which have not yet been resolved, and these must be mentioned specifically lest it be assumed that the respondents agree with the trustee's assertion that they abused the corporate form of the debtor.

On remand from the District Court (see *In re Ozark Restaurant Equipment Co., Inc.*, 61 B.R. 750 (W.D. Ark. 1986)), the Bankruptcy Court was to make a determination as to whether the respondents could be held liable under §547 or §548 of the Bankruptcy Code for any amounts held to be owing to the debtor's estate. The bankruptcy court found for the trustee on several causes of action, all of which are now on appeal to the District Court. Crucial to the determination of these issues is whether the sales of restaurant equipment and supplies made by the debtor to the respondent's other businesses were for a reasonably equivalent value.

The trustee asserts and the lower court found that an average markup of 30% was standard in the industry for restaurant equipment sales. However, the basis for this factual finding is not supported by the testimony in the record. The trustee's own expert testified that a company could operate on a 20% average markup. Furthermore, the trustee's assertion and the finding of the bankruptcy court that the debtor only charged a 7% markup on sales to the respondent's other businesses is also erroneous. The record clearly shows that a 10% markup was charged, and that only on two or three isolated sales was a markup of less than 10% used.

The trustee also misled the court below when it was asserted that sales tax was not charged to Anderson entities. The trustee's own evidentiary exhibits clearly reflect that a 4% sales tax was charged on sales made by the debtor to Anderson entities. And as for the assertion that "typical markups for other Ozark customers was between twenty-eight and ninety percent"—this is simply a misstatement of the facts. True, evidence was introduced to show that at least one sale was made for a 28% markup and another one for a 90% markup, but these were not shown to be representative sales. Indeed, evidence was also introduced to show that on at least one occasion the debtor sold equipment for a 10% markup to another customer.

As for the trustee's assertion that the respondents had prepared "fraudulent balance sheets to entice suppliers to sell merchandise to Ozark on credit", there was testimony at trial that these balance sheets were not used to represent the assets of the debtor. Significantly, aside from bare assertions by the trustee, there was no creditor who testified at trial that they had been sent one of these alleged fraudulent balance sheets or relied on such a balance sheet before extending credit to Ozark. (*In re Ozark*, 61 B.R. at 752).

Also, the Court below found that all sales to the respondent's other businesses comprised only 23 percent of the debtor's total sales. (*In re Ozark*, 61 B.R. at 752). Surely this cannot be a sufficient basis for holding the respondents liable for all the debtor corporation's bad debts, many of which were due to other factors including the bad business judgment of the debtor's president, Mr. Eads.

In short, there are a number of factual issues which have not yet been resolved, and which the respondents argue will preclude any recovery from them on an alter ego theory in any event, since they did not abuse the corporate form of the debtor. These matters are brought to the Court's attention only because the trustee paints such a one-sided picture in her statement of the case.

SUMMARY OF THE ARGUMENT

In the first place there is no conflict between the issue decided in this case by the Eighth Circuit Court of Appeals and any other Circuit Court of Appeals decision. The petitioner's reliance upon the holding of the Fifth Circuit in *In re S.I. Acquisition*, 817 F.2d 1142 (5th Cir. 1987), as being in conflict with the decision of the Eighth Circuit in the instant case is unfounded. The issue in *S.I. Acquisition* (supra) was not whether the trustee had standing to assert an alter ego action on her own, but whether section 362 of the Bankruptcy Code would operate to stay a state court action by a creditor of the debtor against entities affiliated with the debtor corporation. Therefore the issues decided by the Eighth Circuit and the Fifth Circuit were clearly not the same and a conflict does not exist.

Furthermore, the trustee's powers under Section 544, the strong-arm clause, are determined by applicable state law. The District Court and the Eighth Circuit Court of Appeals correctly held that in Arkansas an alter ego action is personal to creditors of a debtor corporation and that therefore a trustee, as the representative of the debtor, does not have standing to bring an alter ego claim on her own without creditor intervention. The trustee's assertion that *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1971), is not controlling on this issue is also erroneous. *Caplin* (supra) denied standing to the trustee in a Chapter X proceeding to bring an alter ego claim on behalf of the bankrupt corporation's creditors (debenture holders) against a third party, the indenture trustee. The Court recognized that the legislature was empowered to grant such standing to a bankruptcy trustee and specifically invited Congress to do so at the close of that opinion.

However, as the Eighth Circuit Court of Apeals is careful to point out, when the overhauled Bankruptcy Code was enacted in 1978, a specific provision which was passed by the House of Representatives (Section 544 (c)) was

deleted before promulgation of the final version of Section 544. Since Section 544 applies to both reorganization and liquidation trustees, there can be no other interpretation of Congressional intent than that Congress did not give standing to bankruptcy trustees to assert alter ego claims without creditor intervention. Therefore, the rationale of *Caplin* (supra) also controls the instant case.

REASONS FOR DENYING WRIT

I.

THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS IS NOT IN CONFLICT WITH OTHER APPELLATE COURT DECISIONS.

The trustee asserts in her brief that the decision of the Eighth Circuit creates an intolerable conflict with other appellate court decisions. However, she cites no case, nor has an exhaustive research by the respondent found a case, wherein another Circuit Court of Appeals decision is in direct conflict with the Eighth Circuit's opinion denying a bankruptcy trustee standing to bring an alter ego action against former shareholders and directors of a debtor corporation.

The trustee's reliance on the Fifth Circuit Court of Appeal's decision in *In re S.I. Acquisition, Inc.*, 817 F.2d 1142 (5th Cir. 1987) as a basis for her claim of a conflict between the Circuit Courts of Appeal is misplaced. In that case the 5th Circuit did reverse the lower court's decision, but the issue in *S.I. Acquisition* was not whether the bankruptcy trustee had standing to assert an alter ego action on her own, but rather the issue was "whether the prosecution of a state court suit that is premised solely upon the theory that the defendants therein are the controlling entities or persons of a chapter 11 debtor (and thus accountable for the debtor's debts) is automatically stayed as to all parties involved by section 362(a)(1) or (3) upon the filing of the debtor's bankruptcy petition." *In re S.I. Acquisition*, 817 F.2d at 1150. Furthermore, the *S.I. Acquisition* case was concerned with a Chapter 11 bankruptcy proceeding and the court felt that to allow the plaintiff to pursue its state court action would abridge "the general policy of giving the debtor and its control persons the opportunity to reorganize its finances." *In re S.I.*

Acquisition, 817 F.2d at 1154. Nowhere in the opinion does the 5th Circuit hold that a Chapter 7 trustee in a corporate liquidation has standing on her own to bring an alter ego action. There appears to be no Circuit Court of Appeals decision dealing with the specific issue involved in the instant case. Therefore the trustee's assertion that there is an "intolerable conflict with other appellate court decisions" is unfounded.

After careful consideration of the Arkansas Supreme Court's decisions on piercing the corporate veil, the 8th Circuit held that "Because the corporate entity will be disregarded under Arkansas law only if it has been abused to the detriment of a third person, and because the nature of the alter ego theory of piercing the corporate veil makes it one personal to the corporate creditors rather than the corporation itself, it is axiomatic that the claim does not become property of the estate under Section 541(a)(1), nor is it enforceable by the trustee under Section 704(1)." *In re Ozark Restaurant Equipment Co., Inc.*, 816 F.2d 1222, 1225 (8th Cir. 1987).

The Bankruptcy Court decisions which the trustee cites in her brief in support of her contention that the trustee has standing to assert an alter ego action on her own, as well as the 5th Circuit opinion in *S.I. Acquisition* (supra), are based on state law as much as on those court's interpretations of the Bankruptcy Code. *In re Mortgage American Corp.*, 714 F.2d 1266 (5th Cir. 1983), which the trustee cites to support her point, also concerned the automatic stay provisions of the Bankruptcy Code and a state court action by a creditor off the debtor outside of bankruptcy. The Texas state law on piercing the corporate veil was crucial to the decision. "The relationship between the new Bankruptcy Code and the various state law causes of action assertable by creditors in state court is, as we have already intimated, both complex and determinative of the outcome of the present litigation." *In re Mortgage America*, 714 F.2d at 1273. That court goes on to say that "the scope of

the automatic stay under section 362 depends upon how the Texas Courts would characterize a cause of action under the trust fund (denuding) theory. If an action under that theory belongs, under Texas law, to the corporation, then the action is "property of the estate" and the bank may not pursue it." *In re Mortgage America Corp.*, 714 F.2d at 1276. The Court held that "Under Texas law the action is in the right of the corporation and, as such, is "property of the estate" within the meaning of section 541(a)(1) of the Code. The automatic stay therefore applies." *In re Mortgage America Corp.*, 714 F.2d at 1277.

Although the trustee is careful to point out that both Texas and Nevada seem to allow an alter ego action by the trustee in bankruptcy by citing this Court to *In re S.I. Acquisition*, 58 B.R. 454 (Bankr. W.D. Tex. 1986), rev'd, 817 F.2d 1142 (5th Cir. 1987), and to *In re Western World Funding Inc.*, 52 B.R. 743 (Bankr. D. Nev. 1984), she fails to point out—even though all of those courts did so in their opinions—that at least two other states have decided the issue differently. See *Stodd v. Goldberger*, 73 Cal. App. 3d 827, 141 Cal. Rptr. 67 (1977), and *In re Green Valley Seeds, Inc.*, 27 B.R. 34 (Bankr. D. Ore. 1982). Both California and Oregon have held that a bankruptcy trustee may not pursue an alter ego action on her own because under state law that cause of action is personal to creditors and does not belong to the corporation.

Arkansas law, as interpreted by the District Court and the 8th Circuit Court of Appeals in the instant case, likewise does not allow the trustee to pursue such a cause of action unless a creditor joins in the suit. This was exactly the situation in *Henderson v. Rounds & Porter Lumber Co.*, 99 F. Supp. 376 (W.D. Ark. 1951). Both the District Court and the 8th Circuit opinions point out that *Henderson* is a different situation than ~~when~~ the trustee asserts an alter ego claim on her own. The Eighth Circuit also points out that although some states may permit a trustee to bring an alter ego action on her own without a creditor joining,

Arkansas does not. (*In re Ozark*, 816 F.2d at 1226, N. 7). Furthermore, as that court points out, the trustee could have brought the alter ego claim and avoided the standing requirement by having one of the debtor's creditors join in the suit. In this case the creditors were asked to join in the suit but none of them wished to do so. (*In re Ozark*, 816 F.2d at 1223, n. 3.) It is beyond comprehension why the trustee should be allowed to bring this claim when the very creditors who would benefit by any recovery, after the trustee's fees and all other administrative expenses are paid, refused to join in such a suit.

II.

THE EIGHTH CIRCUIT'S DECISION IN THIS CASE WILL NOT ADVERSELY AFFECT FEDERAL BANKRUPTCY LAW, AND IN FACT THE DECISION QUESTIONED HEREIN IS A CORRECT INTERPRETATION OF THE TRUSTEE'S LACK OF STANDING TO BRING AN ALTER EGO ACTION AS REFLECTED BY THE REQUIREMENTS OF ARTICLE III OF THE UNITED STATES CONSTITUTION AND THE INTENT OF THE LEGISLATURE IN REVISING THE BANKRUPTCY CODE.

The Trustee asserts in her brief that the holdings of the District Court and the Eighth Circuit Court of Appeals were based in a large part on the Court's holding in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1971). While this may be true of the District Court's opinion, the same cannot be said of the holding of the Eighth Circuit. That court made an exhaustive research of the legislative history of the new Bankruptcy Code and the pre-code decision of *Caplin* (supra), concluding that since Congress had failed to enact a proposed Section 544(c) which would have specifically overruled *Caplin*, (see notes 9 and 10 of the 8th Circuit's opinion—816 F.2d at 1227-28) that therefore "Because subsection (c), as part of Section 544, would have applied to both reorganization and liquidation trustees, and because Congress refused to enact subsection (c), we believe

Congress' message is clear—no trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee as in the present case, has power under Section 544 of the Code to assert general causes of action, such as the alter ego claim, on behalf of the bankrupt estate's creditors." *In re Ozark*, 816 F.2d at 1228.

This respondent cannot improve on the logic or the analysis of the Eighth Circuit's opinion regarding the intent of Congress and the legislative history of section 544 of the Bankruptcy Code in the wake of the *Caplin* decision. Suffice it to say that it is impossible to imagine a more accurate interpretation of Congress' inaction after the *Caplin* Court's explicit invitation for Congress to give a trustee the standing which is sought in this case.

There are also practical reasons why a bankruptcy trustee should be denied standing to assert an alter ego claim. As the District Court pointed out:

> "In a Chapter VII proceeding, giving (the trustee) such standing creates a situation rife with conflicts, conflicts which can only be resolved if the creditors alone are recognized as proper parties plaintiff in an alter ego proceeding.
>
> One of the duties of a Chapter VII trustee is to "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. §704(4). One of his duties, then, is to whittle the number of unsecured claims against the estate. If, however, a third party exists who is "good" for the claims, the trustee has no motive to pursue his duties under §704(4). In fact, given that his compensation depends on the size of the estate, he actually has an interest in allowing as many claims as possible so that the recovery, and his compensation, is as large as possible." *In re Ozark Restaurant Equipment Co., Inc.*, 61 B.R. 750, 757 (W.D. Ark. 1986).

The trustee's brief to this Court in support of her petition for certiorari actually supports the District Court's

analysis of this conflict. The trustee asserts that "the essence of an alter ego claim is that it seeks to tap a pool from which to satisfy its claims against the Debtor. This "pool" is made up of the assets of the alleged alter ego . . . . We think that it is safe to assume that this "pool" is infinite." (Trustee's Brief at page 15.)

Obviously the trustee believes that these respondents have infinite resources with which to satisfy any and all claims against the bankrupt estate, thereby negating any motive the trustee may have had to otherwise examine more closely those claims asserted against the estate and to object to those which may have no merit. This is precisely the sort of conflict between the trustee's duty to investigate claims against the estate and an alter ego action to which the District Court referred.

The Eighth Circuit also points out that the *Caplin* Court's concern with whether creditors would be bound by any settlement or decision rendered in favor of the trustee is also applicable in this case. "If the trustee in the instant case was allowed to pursue and recover on the alter ego cause of action on behalf of Ozark's creditors, there obviously would be questions as to which creditors were bound by the settlement. (Citations omitted). This is because the trustee is not the real party in interest, and thus does not have the power to bind the creditors to any judgment reached in the litigation." *In re Ozark*, 816 F.2d at 1230.

Finally, there is another practical concern which was raised by the District Court in the instant case. If a trustee in a reorganization does not have standing to assert an alter ego claim when it would obviously be beneficial to the corporation in terms of lightening the debtor corporation's repayment plan, then why should the trustee have such power in a Chapter VII liquidation? "At least in the former instance, an interest of the entity is being addressed. In a Chapter VII case, only creditor interests are being asserted." *In re Ozark*, 61 B.R. at 753.

CONCLUSION

For all the foregoing reasons, the respondents respectfully request that the Court deny the trustee's Petition for a Writ of Certiorari.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Raymond C. Smith, hereby certify that I have served a true and correct copy of the above and foregoing document on all parties listed below by placing same, postage prepaid, in the U.S. Mail this 12th day of August, 1987.

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